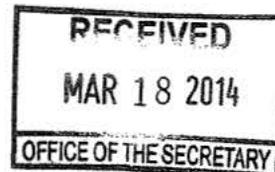


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UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

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ADMINISTRATIVE PROCEEDING
File No. 3-15627



In the Matter of

TRI-STAR ADVISORS, INC.,
WILLIAM T. PAYNE, and
JON C. VAUGHAN,

Respondents.

**DIVISION OF ENFORCEMENT'S MOTION FOR SUMMARY DISPOSITION
AND RESPONSE IN OPPOSITION TO RESPONDENTS' MOTION
FOR SUMMARY DISPOSITION AND BRIEF IN SUPPORT**

Dated: March 14, 2014

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MISCELLANEOUS

Interpretation of Section 206(3) of the Investment Advisers Act of 1940,
SEC Rel. No. IA-1732 (July 17, 1998), 1998 SEC LEXIS 148311

Pursuant to Rule 250 of the Commission's Rules of Practice, the Division of Enforcement ("Division") of the Securities and Exchange Commission ("Commission") files this Motion for Summary Disposition and Response in Opposition to the Motion for Summary Disposition of Respondents Tri-Star Advisors, Inc. ("TSA"), William T. Payne ("Payne"), and Jon C. Vaughan ("Vaughan") and Brief in Support ("Motion").¹ Because there is no genuine issue of material fact, the Division is entitled to summary disposition as a matter of law. 17 C.F.R. § 201.250(b).

SUMMARY

From July 2009 through July 2011, TSA, a registered investment advisor, engaged in thousands of principal transactions without providing written disclosures and obtaining clients' consent for each transaction in violation of Section 206(3) of the Investment Advisers Act of 1940 ("Advisers Act") ("Section 206(3)"), and failed to implement policies and procedures that would prevent the violations, which in turn violated Advisers Act Section 206(4) and Rule 206(4)-7 thereunder. Payne and Vaughan are registered representatives and owners of both TSA and its affiliated broker-dealer, Tri-Star Financial ("TSF"). The facts here are not in dispute: Payne and Vaughan personally placed the trades at issue through TSF in its inventory account, determined the mark up, and then allocated the securities to TSA advisory clients without providing written notice and obtaining client consent for each transaction. They received over \$1 million in sales credits for those principal trades during the relevant period. While the underlying facts are undisputed, Respondents TSA, Payne, and Vaughan moved for summary disposition on the legal implication of those facts, arguing simply that they should escape liability for the violations because neither of them understood the federal securities laws governing their securities firms. But far from exonerating them, Respondents' motion only confirms their liability.

¹ The Division attaches hereto as "Exhibit 1" an appendix ("App.") containing evidence in support of its Motion. Citations are to "App. [page number]."

This matter presents a purely legal issue appropriate for summary disposition in the Division's favor. TSA has admitted the underlying conduct, and there is no *scienter* element in a Section 206(3) or 206(4) violation. As experienced securities professionals and fiduciaries who own both a broker-dealer and its affiliated investment adviser and who directly participated in the conduct at issue, Payne and Vaughan's admitted ignorance of the disclosure and client consent rules with respect to their business and their failure to implement policies to avoid violations of such rules establishes their recklessness as a matter of law. Respondents have violated the law, and their ignorance is no excuse. Therefore, the Court should grant summary disposition for the Division. At a minimum, Respondents' Motion should be denied in its entirety.

STATEMENT OF FACTS

A. Respondents Are Fiduciaries and Experienced Securities Professionals.

1. TSA is a registered investment adviser, and Payne and Vaughan, its CEO and President, respectively, are associated persons of an investment adviser. (Answer, ¶ 2; Advisors Act Section 202(a)(17).) Investment advisers and their associated persons are fiduciaries.² *In re Daniel Bogar, et al.*, SEC Rel. No. ID-502, 2013 WL 3963608, at *19 (Aug. 2, 2013).

2. From at least July 2009 and during all relevant periods, Payne and Vaughan owned and controlled both TSA and TSF, its affiliated registered broker-dealer. (Answer, ¶¶ 4-6.)

3. As of December 2012, TSA managed 313 accounts on a non-discretionary basis and had approximately \$162 million in assets under management. (Answer, ¶ 3.)

4. Payne has over 22 years of experience in the securities industry, having served as the President and registered representative of TSF since 1992. (Rep. Mo., Ex. 7.)

² As fiduciaries, Respondents are required "to act for the benefit of their clients . . . and to exercise the utmost good faith in dealing with clients, to disclose all material facts, and to employ reasonable care to avoid misleading clients." *SEC v. DiBella*, 2007 WL 2904211, at *12 (D. Conn. Oct. 3, 2007) (quoting *SEC v. Moran*, 922 F. Supp. 867, 895-96 (S.D. N.Y. 1996), *aff'd*, 587 F.3d 553 (2d Cir. 2009)).

5. Vaughan has over 20 years of experience in the securities industry, having served as the Executive Vice President, Principal and registered representative of TSF since 1994. (*Id.*)

6. Payne and Vaughan are responsible for ensuring that TSA complies with its regulatory requirements, including Advisory Act requirements. (Answer, ¶ 9.)

B. Payne and Vaughan Established the Business Structure and Directed and Controlled the Principal Trading.

7. Payne and Vaughan make investment recommendations to TSA clients and, upon the clients' consent, TSF executes the transactions. (Answer, ¶ 8.)

8. During the relevant period, TSF used its inventory account to purchase mortgage-backed bonds for TSA advisory clients and then transferred the bonds to the applicable client account. TSF charged the advisory clients a sales credit for the trades, which was essentially a percentage mark-up (or mark-down). Payne and Vaughan, registered representatives of TSF for the trades, received 55% of the sales credit generated by each trade. (Answer, ¶ 8.)

9. From July 2009 through July 2011, TSA, through TSF, engaged in over 2,000 principal transactions with its advisory clients. Payne and Vaughan placed nearly all of those trades. (App. 1-11.)

10. TSF paid approximately \$1 million to Payne and Vaughan as their percentage of the sales credits TSF charged to clients in connection with the principal transactions. (Answer, ¶ 11; App. 1-3.)

C. TSA Did Not Provide Written Disclosure to Advisory Clients or Obtain Client Consent For Each Principal Trade.

11. Prior to approximately October 2011, TSA did not, for each transaction, provide prior written disclosure to advisory clients that it would cause its affiliate, TSF, to effect the trades on a principal basis, nor did it obtain clients' consent for each such transaction before the

transaction was completed. (App. 51 [at pgs. 113-115]; App. 42 [at pg. 43].)

D. An OCIE Examination Revealed That TSA Was Engaged in Undisclosed Principal Trading and That It Did Not Have in Place Procedures Designed to Prevent Advisers Act Violations.

12. The staff of the Commission's Office of Compliance Examinations ("OCIE") and Inspection conducted a compliance examination of TSA in April 2011. The examination found the following deficiencies, among others, and reported them to Vaughan as President of TSA in a letter dated August 31, 2011 ("Deficiency Letter"):

- Principal Trading – Section 206(3)

...

Registrant [TSA] engaged in numerous principal trades with clients effected through its affiliated broker-dealer, Tri-Star Financial AKA Mutual Money Investments, Inc. Trades were processed in this manner routinely in violation of Section 206(3). Registrant's affiliated broker-dealer earned approximately \$1.2 million in sales credits on principal trades during the examination period. Registrant's conduct is not consistent with the requirements of Section 206(3)."

- Compliance Policies and Procedures – Rule 206(4)-7

...

Registrant has adopted a compliance manual ("Manual"); however, the Manual contains procedures for areas that are not applicable to Registrant's operations and the manual does not contain other needed procedures. For example . . . Registrant does not have procedures addressing principal trading. Registrant's Manual is not reasonably designed to prevent violations of the Advisers Act.

(App. 30-34.)

E. After Receiving the Deficiency Letter, TSA Took Steps to Remedy its Adviser Act Violations.

13. In response to the Deficiency Letter, TSA asked its consultant to put procedures in place to bring them into compliance, culminating in a written response to the Deficiency Letter dated November 29, 2011 and signed by Vaughan. (App. 35-39; App. 47 [at pgs. 69, 72] and App.

49 [at pgs. 82-84].) Notably, Respondents did not challenge or object to the examination's findings. (*Id.*)

14. Thereafter, TSA's compliance consultant conducted an annual compliance review for the year 2011 and presented its findings to TSA management, including Payne and Vaughan. It found that:

- "TSA enacts most of its fixed income trades through TSF, its affiliated broker/dealer. These trades are completed as principal trades by TSF, in which the bonds are marked up before selling to clients or marked down when buying from clients. Trades enacted early in the year were not treated as principal trades meeting the requirements of Section 206(3)." (App. 22.)
- "A full disclosure program was designed and put in place by year-end [2011] and included changes to TSA's disclosure document to more accurately disclose the conflict." (*Id.*)
- The SEC exam uncovered the fact that principal trades were occurring without notifying clients beforehand. Policies and procedures have now been put into place to rectify this situation. Forms were also created to facilitate the process." (App. 26.)

ARGUMENT AND LEGAL AUTHORITY

A. The Division is Entitled to Summary Disposition Against TSA for its Willful Violations of Advisers Act Sections 206(3) and 206(4) and Rule 206(4)-7 thereunder.

1. Undisclosed Principal Transactions: Advisers Act Section 206(3)

A "principal transaction" occurs when an adviser, acting for its own account, buys a security from, or sells a security to, the account of a client. *Interpretation of Section 206(3) of the Investment Advisers Act of 1940*, SEC Rel. No. IA-1732 (July 17, 1998) ("*Interpretive Release*"), 1998 SEC LEXIS 1483, at *4. Because principal transactions pose the potential for conflicts of interest between the adviser and the client, Congress, in enacting Section 206(3) in 1940, imposed a disclosure and client consent requirement on any adviser that acts as principal in a transaction with a client, or that acts as broker (*i.e.*, an agent) in connection with a transaction for, or on behalf of, a client. *Id.* Specifically, Section 206(3) makes it unlawful for any investment adviser, directly

or indirectly:

acting as principal for his own account, knowingly to sell any security to or purchase any security from a client, or acting as broker for a person other than such client, knowingly to effect any sale or purchase of any security for the account of such client, without disclosing to such client in writing before the completion of such transaction the capacity in which he is acting and obtaining the consent of the client to such transaction.

Advisers Act Section 206(3). The Commission applies Section 206(3) not only to principal transactions engaged in or effected by an adviser, but also to situations when an adviser causes a client to enter into a principal transaction that is effected by an affiliated broker-dealer. *Interpretive Release*, 1998 SEC LEXIS 1483, at *3 n.3. (*citing* Commission guidance on this point dating back to 1973).

There can be no dispute that TSA engaged in undisclosed principal trading. Respondents have admitted that TSA directed TSF to effect purchases or sales of securities in TSF's account on behalf of TSA's clients. (*See, e.g.*, Answer, ¶ 8; Resp. Motion at 5, 11.) This is the definition of principal trading. ("*Interpretive Release*"), 1998 SEC LEXIS 1483, at *4. They also admit that until during the relevant period, written disclosure was not delivered to advisory clients on a transaction by transaction basis for each principal transaction, and that each client's consent was not obtained before the settlement date of each principal transaction. (App. 26, 37 [describing corrective action taken].) Following the OCIE examination, Respondents worked with TSA's outside consultant to take corrective action and bring the firm into compliance with the requirements of the Advisers Act. (*Id.*).

While TSA does not dispute the underlying conduct and the fact that it engaged in principal trading, it attempts to avoid legal liability for the violations by inserting a *scienter* element into Section 206(3) that does not exist. To do this, TSA is forced to re-write the

statute. TSA claims that “Section 206(3) prohibits an adviser from *knowingly* engaging in principal transactions without prior disclosure and consent of the client.” (Resp. Motion at p. 13) (emphasis in original). But that is not what the statute says. The actual language of the statute prohibits an advisor, when acting as principal for his own account, “*knowingly to sell any security to or purchase any security from a client . . .*,” OR when acting as an agent in connection with a transaction for, or on behalf of, a client, “*knowingly to effect any sale or purchase of the security*” for the client’s account. Advisers Act Section 206(3) (emphasis added). The word “knowingly” in Section 206(3) quite plainly modifies the act of purchasing, selling, or effecting a purchase or sale—an act that in this case is not in dispute.³

However, even if *scienter* were an element of the primary violation, which it is not, “[k]nowledge means awareness of the underlying facts, not the labels that the law places on those facts. Except in very rare instances, no area of the law, not even the criminal law, demands that a defendant have thought his actions were illegal.” *SEC v. Falstaff Brewing Corp.*, 629 F.2d 62, 77 (D.C. Cir. 1980), *cert. denied sub nom., Kalmanovitz v. SEC*, 449 U.S. 1012 (1980). The undisputed facts show that TSA, through Payne and Vaughan, engaged in principal transactions without following the proper disclosure and client consent procedures mandated by the federal securities law. TSA is accountable for the actions of its responsible officers, including Payne and Vaughan. *See, e.g., In re Zion Cap. Mgmt. LLC*, SEC Rel. No. 220, 2003 WL 193535, at *8 (Jan. 29, 2003). Thus, the advisor should be held liable for its violations.

³ Respondents’ arguments and citations to cases interpreting the “knowing” element of Exchange Act Section 13(b)(5) are inapposite and should be ignored. *See* Resp. Motion at pp. 13-14. In that provision, unlike Section 206(3), the word “knowing” specifically modifies the act of circumventing or failing to implement a system of internal accounting controls, and has no application to this case. *See* U.S.C. § 78m(b)(5).

Further, TSA intended to place the trades in TSF's inventory account. Thus, its conduct was willful. *See id.* at *9 ("A finding of willfulness does not require an intent to violate, but merely an intent to do the act which constitutes a violation."). Accordingly, the Court should deny TSA's Motion, and grant summary disposition for the Division on this claim.

2. Failure to Adopt Policies and Procedures to Prevent Violations: Advisers Act Section 206(4) and Rule 206(4)-7

Section 206(4) of the Advisers Act prohibits an investment adviser from, directly or indirectly, engaging in any act, practice or course of business which is fraudulent, deceptive, or manipulative. 15 U.S.C. § 80b-6(4). Rule 206(4)-7 defines such prohibited conduct to include the failure to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and Rules promulgated thereunder. 17 C.F.R. § 275.206(4)-7. *Scienter* is not required for violations of Section 206(4) and Rule 206(4)-7, and the Division does not have to prove it in order to establish the Respondents' liability. *SEC v. Steadman*, 967 F.2d 636, 647 (D.C. Cir. 1992). Thus, a showing of negligence is adequate to establish TSA's liability. *Bogar*, 2013 WL 3963608, at *19. Negligence is the failure to exercise reasonable care. *Id.*

TSA cannot dispute that the compliance manual that was in effect during the relevant period did not contain a provision addressing principal trading. TSA did not implement disclosure and consent procedures for its principal transactions until November 2011. (App. 22.) Because nearly all of the advisory client trades in mortgage-backed bonds were executed through TSF's inventory account, and thus, were principal trades, TSA was negligent as a matter of law in failing to adopt policies and procedures that would prevent it from violating the disclosure and client consent rules relating to those trades. Thus, summary disposition for the Division on this claim is proper.

B. The Division is Entitled to Summary Disposition Against Payne and Vaughan for Wilfully Causing and Aiding and Abetting TSA's Violations of Advisers Act Sections 206(3) and 206(4) and Rule 206(4)-7 thereunder.

For aiding and abetting liability under the federal securities laws, the Division must establish: (1) that a primary securities law violation was committed by another party; (2) awareness by the aider and abettor that his or her role was part of an overall activity that was improper; and (3) that the aider and abettor knowingly and substantially assisted the conduct that constitutes the violation. *Bogar*, 2013 WL 3963608, at *20; *Graham v. SEC*, 222 F.3d 994, 1000 (D.C. Cir. 2000). "A person cannot escape aiding and abetting liability by claiming ignorance of the securities laws." *Bogar*, 2013 WL 3963608, at *20; *In re Sharon M. Graham, et al.*, SEC Rel. No. 34-40727, 1998 WL 823072, at *7 n.33 (Nov. 30, 1998). The "knowledge" or "awareness" requirement can be satisfied by recklessness when the alleged aider and abettor is a fiduciary or an active participant. *Bogar*, 2013 WL 3963608, at *20.

For "causing" liability, the Division must establish: (1) a primary violation; (2) an act or omission by the respondent that was a cause of the violation; and (3) the defendant knew, or should have known, that his conduct would contribute to the violation. *Id.* A respondent who aids and abets a violation is also a cause of the violations under the federal securities laws. *Id.* Negligence is sufficient to establish liability for causing a primary violation that does not require *scienter*. *Id.*

1. Vaughan and Payne Aided and Abetted and Caused TSA's Undisclosed Principal Trading.

Vaughan and Payne each argue that because he did not understand that TSA's practice of causing its affiliated broker-dealer to effect trades in its inventory account on behalf of TSA's client was a "principal trade" subject to the requirements of Section 206(3), he could not have been "aware" that his role was part of an overall improper activity or could not have "knowingly" assisted in the conduct at issue. (Resp. Motion at

p.5, 6, 11.)

The Commission has rejected this very argument numerous times. For example, in *Geman*, the former CEO of a registered broker-dealer and investment adviser argued that he could not be found to have willfully caused or aided and abetted violations of the securities laws at issue because he claimed he acted in good faith at all times and did not know that his actions or omissions violated the law. SEC Rel. No. IA-1924, 2001 WL 124847, at *17 (Feb. 14, 2001). In finding him liable, the Commission held that “securities professionals . . . are part of a highly regulated industry and, as such, [are] required to know the law that is applicable to their conduct within that industry. In light of this requirement, it would make no sense to permit ignorance of the law to serve as a defense.” *Id.*; *Bogar*, 2013 WL 3963608, at *20 (“A person cannot escape aiding and abetting liability by claiming ignorance of the securities laws.”); *Graham*, 1998 WL 823072, at *7 n.33; *see also Falstaff Brewing Corp.*, 629 F.2d at 77; *Camp v. Dema*, 948 F.2d 455, 459 (8th Cir. 1991).

In this case, even if ignorance of the law were a defense, which it is not, the undisputed facts establish that these fiduciaries were active participants in the conduct at issue from both the adviser and the broker-dealer sides of the transactions, and thus, were reckless in not knowing the rules that govern their business. For example, Vaughan and Payne are the registered representatives that placed nearly all of the more than 2,000 trades with TSF, the broker-dealer they had owned and operated for nearly 20 years. They reviewed the TSF sales commission reports and all of the trades. (App. 50 [at 99-100].) They personally received from TSF over \$1 million in sales credits from the principal trading during the relevant period. (*Id.*) Payne testified he reviewed the TSF trade tickets,

he decided the markup for particular transactions, and he was well aware of TSF's procedure of purchasing the securities in its inventory account before it was allocated to the TSA client, describing himself and Vaughan as being "very engaged in the trading." (App. 46, 48, and 49 [at p. 28, 73-80].) Vaughan also testified to his knowledge of TSF's procedure of buying a bond and placing it in the inventory account to be marked up and sent to the TSA omnibus allocation account, and then on to the TSA client. (App. 41-42 [at ps. 40-41].)

While Payne and Vaughan apparently were not educated on the legal effect of their actions, that ignorance was reckless, or at the very least, negligent. They have been involved in the securities industry since the early 1990s; they are co-owners of both a registered investment adviser and a broker-dealer; and they provide advisory service in a fiduciary capacity to over 300 clients. Furthermore, the concept of principal trading, even through affiliates, is well established in the securities industry. *See Interpretation of Section 206(3) of the Investment Advisers Act of 1940*, SEC Rel. No. IA-1732 (July 17, 1998), 1998 SEC LEXIS 1483, at *3 n.3 ("We and our staff have applied Section 206(3) to apply not only to principal and agency transactions engaged in or effected by any adviser, but also to certain situations in which an adviser causes a client to enter into a principal or agency transaction that is effected by a broker-dealer that controls, in controlled by, or is under common control with, the adviser.") (citing Staff No-action letter, *Hartzmark & Co.*, (avail. Nov. 11, 1973) (applying Section 206(3) when an adviser effects transactions through its broker-dealer parent)).⁴ The notice and client consent requirements of Section 206(3) have been

⁴ *See also, e.g., Arleen W. Hughes*, 27 S.E.C. 629, 635 (1048) ("It is well settled that a fiduciary, as for example, an agent, who sells his own property to his principal must disclose his cost to the principal so that the principal will know what profits the fiduciary will realize by effecting the transaction."), *aff'd sub nom., Hughes v. SEC*, 174 F.2d 969 (D.C. Cir. 1949); *William J. Stelmack Corp.*, 11 S.E.C. 601, 618 (1942) (stating that an agent must disclose not only that he "is acting on his own account, but also all other facts which he should realize have or are likely to have a bearing upon the desirability of the transaction from the viewpoint of the principal [including] the price paid by the Division's Motion for Summary Disposition and Response To Respondents' Motion

the law since 1940. Payne and Vaughan's fiduciary responsibility for and direct participation in the conduct at issue mandates that they should have known the basic disclosure rules with respect to using an affiliated broker-dealer to effect trades. Their admitted failure to do so is reckless as a matter of law. *See, e.g., Geman*, 2001 WL 124847, at *17.

Moreover, Respondents cannot negate their recklessness by claiming a generic "good faith" reliance on the consultant TSA hired to register it as an investment adviser with the State of Texas. Respondents do not even attempt to satisfy their burden of demonstrating that they: (1) made a complete disclosure to the professional; (2) requested the professional's advice as to the legality of the contemplated action; (3) received advice that it was legal; and (4) relied in good faith on that advice.⁵ *See Yuen*, 2006 WL 1390828, at *40; *SEC v. Kenton Capital*, 69 F. Supp. 2d 1, at 10 n.7 (D.D.C. 1998). There is no evidence in the record, and Respondents do not claim, that anyone told the compliance consultant about TSA's practice of directing its affiliated broker-dealer to effect trades in its account on behalf of TSA clients. Likewise, there is no evidence that the consultant was ever asked to provide, or that it provided, any advice on the legality of effecting such transactions without a transaction by transaction disclosure and client consent procedure to justify such reliance until after the violations came to light during the examination in 2011.

To the contrary, Respondents' motion specifically avers that "their consultant did not advise Respondents" about whether its TSF account was a "principal" account for purposes of Section 206(3). (Resp. Mo. at 11.) Vaughan testified that on the TSA side, "that question came

agent for the property which he sells to the principal . . . and the price he receives for the property he buys from the principal").

⁵ Even if they had established these elements, which they have not, good faith reliance on a professional is not an affirmative defense, but simply one factor the Court could consider in evaluating whether they were reckless. *See, e.g., SEC v. Yuen*, 2006 WL 1390828, at *39 (C.D. Cal. 2006). Additionally, this claim is not available when material information was withheld from the professional. *Id.* Therefore, even if the Court considers that argument, it is insufficient as a matter of law to preclude a finding of liability.

up: Are you principal trading? Which I believe we said we don't think we're principal trading because Tri-Star Advisors doesn't have a trading account.” (App. 41 [at p. 37].) Vaughan testified that he contacted the consulting firm after the SEC examination, “and [they] sort of delved into a little bit more, and that was the point where [they] said, Okay this may be principal trading, not because we have an account but because Bill has ownership of an affiliated dealer. So that was when we kind of became aware of the situation.” (App. 41 [at p. 38].) Further, the written report from the consultant in connection with an annual compliance review for 2010 indicates in a “findings” section that the consultant presented the issue that it was “unclear whether principal trades had been effected by the broker/dealer for TSA clients,” and specifically asked Kelly Durham, TSA’s Chief Compliance Officer, to confirm. (App. 14.) (emphasis in original). Vaughan and Payne participated in annual compliance review meetings and, as its highest officers, should have been aware of the findings and the fact that the issue was raised. Despite this red flag, neither Payne nor Vaughan took any steps to address the issue.

The awareness or knowledge requirement can be satisfied by recklessness when the alleged aider and abettor is a fiduciary or active participant, and Payne and Vaughan were both. Thus, they aided and abetted and caused TSA’s violations of Advisers Act Section 206(3). The acts that constituted their violations were clearly intentional (*i.e.*, they purposefully caused TFS to effect principal trades and they profited from that model). Thus, their violations were willful. The Court should grant summary judgment for the Division on this claim. At a minimum, Respondents’ motion should be denied.

2. Vaughan and Payne Aided and Abetted and Caused TSA’s Failure to Adopt Policies and Procedures to Prevent the Violations.

As demonstrated above, Payne and Vaughan structured their business to execute TSA advisory client trades through TFS’s inventory account. As experienced securities professionals

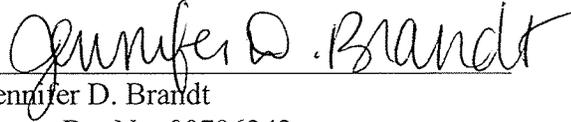
and fiduciaries actively involved in the day to day operations and trading activity of their firms, they should have been aware of disclosure and consent requirements relating to conflicts of interest between their affiliated firms, or should have become aware before operating in violation of those requirements for two years. Payne testified that he actively participated in the drafting of the compliance manual, attending nearly all of the meetings with the consultant and reviewing and approving the final draft. (App. 48 [at p. 73].) Yet, there is no evidence that Payne and Vaughan ever disclosed to the consultant the structure of their trading activity or took steps to ensure proper procedures were followed. Once again, they cannot hide behind their ignorance of the law to excuse their regulatory failures. Payne and Vaughn were the two people responsible for insuring that TSA complied with the federal securities laws, and were active participants in the formation of TSA's policies and procedures. The fact that the compliance manual failed to address procedures that govern principal trading, when nearly all of its advisory trades were executed through their affiliate's inventory account, and they knew it, is reckless as a matter of law. The undisputed facts establish that Payne and Vaughan caused TSA to fail to adopt policies and procedures that would prevent Adviser Act Section 206(3) violations. As such, summary disposition for the Division is proper. Respondents' motion should be denied.

CONCLUSION

For the reasons stated herein, the Division respectfully requests that the Court: (1) deny Respondents' Motion for Summary Disposition; (2) grant the Division's Motion; (3) enter an order finding that: TSA willfully violated Advisers Act Sections 206(3) and 206(4) and Rule 206(4)-7 thereunder; Payne and Vaughan willfully caused and aided and abetted TSA's violations of the Advisers Act; and (4) set a briefing schedule to determine what sanctions are appropriate given Respondents' willful violations.

Dated: March 14, 2014

Respectfully submitted,



Jennifer D. Brandt

Texas Bar No. 00796242

David B. Reece

Texas Bar No. 24002810

United States Securities and
Exchange Commission

Fort Worth Regional Office

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801 Cherry Street, Unit 18

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Reeced@sec.gov

COUNSEL FOR
DIVISION OF ENFORCEMENT

EXHIBIT 1

From: Roy Washington [REDACTED]
Sent: Friday, February 1, 2013 5:28 PM
To: Harris, R. Joann <HARRISR@SEC.GOV>
Cc: Bill Payne <bpayne@tristar.us>; Jon Vaughan <jvaughan@tristar.us>; Kelly Durham <kdurham@tristar.us>
Subject: TSA Response to SEC Information Request
Attach: Exhibit A.xlsx; Exhibit B.xlsx; Exhibit C.xlsx

Good Morning Joann,

Attached you will find the information you requested from my client Tri-Star Advisors, Inc. ("TSA"). Based on my understanding, you wanted information for the review period of November, 2009 to July, 2011 regarding: (1) the total number of alleged principal transactions executed; (2) the total amount of Sales Credit paid by Tri-Star Financial ("TSF") for the alleged principal transactions; and (3) the name of the persons who placed the alleged principal transactions through TSF. You also requested the firm include an explanation of the methodologies used in completing its responses.

The firm's direct response information is contained in the attached Exhibits A, B, and C. Explanations of the methodologies used in preparing this response are described below.

Sales Credit Methodology:

1. Sales Credits are calculated at the time a trade is effected.
2. All Sales Credits are reviewed prior to execution by the firm's head trader and CEO to ensure compliance with relevant FINRA rules (and interpretive materials) relating to prices and commissions, as well as the firm's own internal pricing policies and procedures.
3. When entering the trade into the custodian's trading platform, the back office staff records the total Sales Credit amount on a blotter (examples of the blotter were previously produced and referred to as "Deb's Spreadsheets").
4. At month end the blotter is reconciled against the commission reports from the Custodian (also previously produced and referred to as "SWST Reconciliation").
5. The blotter (Deb's spreadsheets) is then updated if necessary.
6. The total Sales Credit amount is then split - 45% to the Firm and 55% to the producing registered representative and the spreadsheet becomes the Final Payout Report.

Exhibit A was created using the final payout (reviewed and reconciled) report.

Exhibits A, B, and C Methodologies:

1. Exhibit A was calculated as described above and is based on the assumption that all of the factual elements required to trigger the application of Section 206(3) (including the requirements contained in relevant SEC interpretive guidance) to the identified transactions were present at all times during the review period.
2. Exhibit B was calculated by eliminating from Exhibit A all transactions (and the sales credit figures associated with them) that occurred on dates prior to the earliest possible point in time on

APP. 0001

TSA-DOE-0000303

which the "knowingly" element of Section 206(3) could possibly have been met by the firm.

3. Exhibit C was calculated by eliminating from Exhibit B all transactions (and the sales credits figures associated with them) executed by Mr. Vaughan. This was done to reflect the fact that TSA had no direct proprietary trading account(s) during the review period, and Mr. Vaughan has never had a controlling ownership interest in Tri-Star Financial that would trigger the "controlled affiliate" element (contained in relevant SEC interpretive guidance) with respect to his TSA advisory client account transactions.

Finally, it should be noted that none of the exhibits takes into consideration the firm's general compliance self-policing efforts, the remedial action steps already taken (which have now been effectively implemented for more than a year) in response to the firm's Section 206(3) compliance concerns and commitment, or the overall level of the firm's cooperation in the Commission's investigation of this matter. While we certainly understand the Commission's actions regarding the application of its cooperation policies is necessarily a facts and circumstances determination based on the unique situation of a given matter, we believe the described actions of the firm were certainly in the best interest of investors and should be given significant favorable consideration in the ultimate resolution of the matter, as it relates to TSA.

Please let me know if you have any questions on the any of the above. I look forward to the opportunity of having further discussions with you on this matter.

Sincerely,

Roy V. Washington, Esq.
Attorney-at-Law

[REDACTED]

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APP. 0002

TSA-DOE-0000304

TOTAL TRADES FOR PERIOD	2056
TOTAL SALES CREDIT	\$1,820,502.29
TOTAL S/C PAID TO TSF	\$819,227.08
TOTAL S/C PAID TO REPS	\$1,001,275.21

APP. 0003

3/13/2014

Page 1

BROKER	MONTH/YEAR	TOTAL NUMBER TRADES	TOTAL SALES CREDIT	FIRM 45% S/C	BROKER 55% S/C
	Nov-09	23	\$19,992.94	\$8,996.82	\$10,996.12
	Dec-09	18	\$12,592.41	\$5,666.58	\$6,925.83
B PAYNE	Jan-10	16	\$9,750.35	\$4,387.66	\$5,362.69
	Feb-10	14	\$9,108.71	\$4,098.92	\$5,009.79
	Mar-10	26	\$18,185.67	\$8,183.55	\$10,002.12
	Apr-10	27	\$22,296.04	\$10,033.22	\$12,262.82
	May-10	40	\$23,397.05	\$10,528.67	\$12,868.38
	Jun-10	32	\$16,321.87	\$7,344.84	\$8,977.03
	Jul-10	50	\$37,963.54	\$17,083.59	\$20,879.95
	Aug-10	44	\$31,117.37	\$14,002.82	\$17,114.55
	Sep-10	31	\$23,568.63	\$10,605.88	\$12,962.75
	Oct-10	53	\$52,795.17	\$23,757.83	\$29,037.34
	Nov-10	80	\$62,004.20	\$27,901.89	\$34,102.31
	Dec-10	65	\$44,729.02	\$20,128.06	\$24,600.96
	Jan-11	97	\$76,568.28	\$34,455.73	\$42,112.55
	Feb-11	114	\$102,633.89	\$46,185.25	\$56,448.64
	Mar-11	42	\$24,768.38	\$11,146.87	\$13,621.51
	Apr-11	61	\$44,764.93	\$20,144.22	\$24,620.71
	May-11	54	\$28,935.61	\$13,021.02	\$15,914.59
	Jun-11	9	\$4,066.04	\$1,829.72	\$2,236.32
	Jul-11	3	\$321.80	\$144.81	\$176.99
PERIOD	TOTALS	899	\$665,881.90	\$299,647.95	\$366,233.95

APP. 0004

BROKER	MONTH/YEAR	TOTAL NUMBER TRADES	TOTAL SALES CREDIT	FIRM 45% S/C	BROKER 55% S/C
	Nov-09	19	\$31,906.26	\$14,357.82	\$17,548.44
	Dec-09	31	\$55,820.52	\$25,119.23	\$30,701.29
J VAUGHAN	Jan-10	38	\$37,207.50	\$16,743.37	\$20,464.13
	Feb-10	21	\$24,747.04	\$11,136.17	\$13,610.87
	Mar-10	36	\$40,922.77	\$18,415.25	\$22,507.52
	Apr-10	38	\$36,822.03	\$16,569.91	\$20,252.12
	May-10	55	\$43,838.16	\$19,727.17	\$24,110.99
	Jun-10	43	\$35,002.61	\$15,751.17	\$19,251.44
	Jul-10	35	\$48,015.45	\$21,606.95	\$26,408.50
	Aug-10	58	\$57,257.05	\$25,765.67	\$31,491.38
	Sep-10	58	\$36,922.46	\$16,615.11	\$20,307.35
	Oct-10	110	\$108,634.88	\$48,885.68	\$59,749.20
	Nov-10	78	\$87,100.39	\$39,195.18	\$47,905.21
	Dec-10	69	\$70,818.95	\$31,868.53	\$38,950.42
	Jan-11	75	\$105,566.10	\$47,504.74	\$58,061.36
	Feb-11	106	\$118,180.50	\$53,181.22	\$64,999.28
	Mar-11	56	\$30,243.50	\$13,609.57	\$16,633.93
	Apr-11	65	\$53,017.05	\$23,857.67	\$29,159.38
	May-11	33	\$21,669.38	\$9,751.22	\$11,918.16
	Jun-11	11	\$14,415.15	\$6,486.82	\$7,928.33
	Jul-11	4	\$4,366.00	\$1,964.70	\$2,401.30
PERIOD	TOTALS	1,039	\$1,062,473.75	\$478,113.15	\$584,360.60

APP. 0005

BROKER	MONTH/YEAR	TOTAL NUMBER TRADES	TOTAL SALES CREDIT	FIRM 45% S/C	BROKER 55% S/C
	Nov-09	NOT	APPLICABLE	NO	MGD ACCTS
	Dec-09	NOT	APPLICABLE	NO	MGD ACCTS
B TOTH	Jan-10	NOT	APPLICABLE	NO	MGD ACCTS
	Feb-10	NOT	APPLICABLE	NO	MGD ACCTS
	Mar-10	NOT	APPLICABLE	NO	MGD ACCTS
	Apr-10	NO TRADES	NO TRADES	NO TRADES	NO TRADES
	May-10	NO TRADES	NO TRADES	NO TRADES	NO TRADES
	Jun-10	9	\$7,223.20	\$3,250.44	\$3,972.76
	Jul-10	18	\$10,724.97	\$4,826.24	\$5,898.73
	Aug-10	15	\$13,241.75	\$5,958.79	\$7,282.96
	Sep-10	8	\$5,016.28	\$2,257.33	\$2,758.95
	Oct-10	25	\$19,727.50	\$8,877.37	\$10,850.13
	Nov-10	20	\$17,497.50	\$7,873.87	\$9,623.63
	Dec-10	23	\$18,715.44	\$8,421.94	\$10,293.50
	Jan-11	RESIGNED	RESIGNED	RESIGNED	RESIGNED
PERIOD	TOTALS	118	\$92,146.64	\$41,465.98	\$50,680.66

APP. 0006

TOTAL TRADES FOR PERIOD	240
TOTAL SALES CREDIT	\$171,555.96
TOTAL S/C PAID TO TSF	\$77,200.18
TOTAL S/C PAID TO REPS	\$94,355.78

BROKER	MONTH/YEAR	TOTAL NUMBER TRADES	TOTAL SALES CREDIT	FIRM 45% S/C	BROKER 55% S/C
<i>B PAYNE</i>	Apr-11	61	\$44,764.93	\$20,144.22	\$24,620.71
	May-11	54	\$28,935.61	\$13,021.02	\$15,914.59
	Jun-11	9	\$4,066.04	\$1,829.72	\$2,236.32
	Jul-11	3	\$321.80	\$144.81	\$176.99
PERIOD	TOTAL	127	\$78,088.38	\$35,139.77	\$42,948.61

BROKER	MONTH/YEAR	TOTAL NUMBER TRADES	TOTAL SALES CREDIT	FIRM 45% S/C	BROKER 55% S/C
J VAUGHAN	Apr-11	65	\$53,017.05	\$23,857.67	\$29,159.38
	May-11	33	\$21,669.38	\$9,751.22	\$11,918.16
	Jun-11	11	\$14,415.15	\$6,486.82	\$7,928.33
	Jul-11	4	\$4,366.00	\$1,964.70	\$2,401.30
PERIOD	TOTAL	113	\$93,467.58	\$42,060.41	\$51,407.17

TOTAL TRADES FOR PERIOD	127
TOTAL SALES CREDIT	\$78,088.38
TOTAL S/C PAID TO TSF	\$35,139.77
TOTAL S/C PAID TO REPS	\$42,948.61

BROKER	MONTH/YEAR	TOTAL NUMBER TRADES	TOTAL SALES CREDIT	FIRM 45% S/C	BROKER 55% S/C
B PAYNE	Apr-11	61	\$44,764.93	\$20,144.22	\$24,620.71
	May-11	54	\$28,935.61	\$13,021.02	\$15,914.59
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	Jul-11	3	\$321.80	\$144.81	\$176.99
PERIOD	TOTAL	127	\$78,088.38	\$35,139.77	\$42,948.61

TRI-STAR ADVISORS, INC.
ANNUAL REVIEW, 2010

FIRM OVERVIEW

Tri-Star Advisors, Inc. ("TSA" or "Firm"), which had approximately \$140 million under management on 12/31/2010, is related to a broker/dealer firm, Tri-Star Financial, that trades fixed income instruments, with significant investments in CMOs. The Firm manages assets for clients by trading through its broker/dealer and hires sub-advisors to manage equity portions of balanced portfolios. This was the first full year of operation for the Firm, which was established in the final quarter of 2009.

METHOD OF REVIEW

Review conducted by: The Advisor's Resource, Inc. The review was conducted January 25, 2011, and covered the period January 2010-December 2010.

Method of review and documentation: The Advisor's Resource, Inc. ("TARI") reviewed TSA's books and records, compliance materials and client correspondence for 2010, as required by Rule 206(4)-7 of the Investment Advisers Act of 1940 ("Advisers Act"). The review also included an onsite visit with Kelly Durham.

CHANGES IN THE REVIEW PERIOD

A sub-advisor relationship was established to enable the firm to offer equity management to its clients requiring balanced portfolios.

Personnel Changes:

The Chief Compliance Officer position went through significant change in the initial year, but has since stabilized. Marcel Theriot, the president and managing director of Tri-Star Advisors, left the Firm on August 5, 2010.

ANNUAL REQUIREMENTS

Date Privacy Policy was given to clients: When accounts were opened

Date clients received Form ADV: When accounts were opened

Date best execution reviews were held and documented: December 2010

Date Form ADV I was last amended: August 18, 2010

Date of latest revision of Form ADV Part II: August 17, 2010

Date last annual review was conducted: This is TSA's first annual review.

MATERIAL REVIEWED; FINDINGS AND RECOMMENDATIONS FOR EACH

***THE CODE OF ETHICS UPDATES/BREACHES; POLICIES & PROCEDURES
MANUAL UPDATES***

Findings:

- The personal trading policy was reviewed and revised as a result of this review. Pre-clearance requirements in the original trading policy had not been used, so the policy (and summary table) was revised to reflect actual practice of the firm. Personal trades were reviewed as required, and it was determined that no clients had been negatively affected as a result of the lack of pre-clearance. (See attached updated Code of Ethics.)
- Several sections of the manual were not updated to reflect changes that occurred with the Firm.

Regulatory Recommendations:

- Update the manual to include discussion of the pay to play rule and add language regarding the sub-advisor arrangement and how it will be monitored.
- All Firm personnel should annually sign the Code of Ethics/policies and procedures acknowledgement page.

Best Practice Recommendations:

- Review the personal trading policy in June 2011 to ensure that it in fact works to minimize potential conflicts with client trades, as well as to ensure that current procedures are in compliance with the policy.
- Review a manual section each month to ensure the policy reflects current business practices. Make changes appropriately.

ADVERTISING; MARKETING; DISCLOSURE DOCUMENTS; PERFORMANCE

Findings:

- The new Form ADV 2A and 2B have been drafted by The Advisor's Resource and are being reviewed by Firm personnel. It will be completed and ready for submission to the IARD as required by March 31, 2011, and will be mailed to all clients thereafter.
- TSA sends clients (and prospects?) a monthly newsletter, which is generic and covers economic news from a macro level. No specific investment recommendations were made or discussed.
- Two principals of the Firm participate in a daily radio show which runs for an hour or two. Topics include general market and news commentary, and listeners are allowed to call in. Both TSA and Tri Star Financial are mentioned as sponsors of the

show. The CCO monitors the radio show on a periodic basis to ensure advertising rules are followed.

- Tri Star Financial markets through seminars, which occasionally surface potential clients for TSA.

Regulatory Recommendations:

- Add insurance information to Form ADV 2A and 2B.
- Add sub-advisor language to Form ADV 2A.

Best Practice Recommendations:

- Prepare a "cheat sheet" for the TSA personnel participating in the radio show as to "Do's and Don'ts."
- Review any disclaimers made on the show.

ALLOCATION OF INVESTMENT OPPORTUNITIES; VALUATION; TRADING AND TRADE ERRORS; BEST EXECUTION

Findings:

- The original tests for best execution were found to be weak, as the Firm trades in fixed income instruments.
- There were no trade errors during the review period.
- It was unclear as to whether principal trades have been effected by the broker/dealer for TSA clients. *Kelly to confirm.*

Best Practice Recommendations:

- The Advisor's Resource recommends two level of tests in the future for best execution: 1) compare prices for a bond offered to clients through the related broker/dealer with those from a third party; 2) compare markups on bonds across Firm IARs to ensure that one IAR is not consistently marking bonds significantly higher than other IARs.

ANTI-MONEY LAUNDERING

Findings:

- Custodians conduct anti-money laundering tests for new clients and monitor account activity for potential money laundering.

No Recommendations

BOOKS AND RECORDS; CLIENT AND INVESTOR FILES; COMPLAINTS FROM CLIENTS/INVESTORS

Findings:

- There were no formal client complaints during the review period.
- No clients terminated their relationships with TSA during 2010.
- Of the client files that were reviewed, one file was missing the client agreement and several files were missing required signatures. Some clients' quarterly update forms were incomplete.

Regulatory Recommendations:

- Conduct an audit of all client files, making sure all client files are up to date and all agreements have required signatures.

Best Practice Recommendations:

- Consider establishing a procedure for reviewing each new client file to ensure all signatures are in place before the first fees are charged, or before trades are placed in a client's account.

CCO TRAINING

Findings:

- The Firm's CCO attended a one-day seminar for CCOs in April which focused on the new custody rule.

Best Practice Recommendations:

- The Firm may want to send the CCO to the NSCP regional conference in Dallas on April 11 and 12, 2011.
- The CCO might also consider attending and participating in the quarterly local "compliance roundtable."

CONFLICTS OF INTEREST

Findings

- TSA has an affiliated broker/dealer through which the fixed income securities recommended for Firm clients are purchased. IARs mark up the individual bonds, with bonds purchased in blocks as appropriate and all clients receiving the same price.
- TSA also offers insurance products through Texas Annuity Group. These insurance transactions generate compensation to the selling individual in the form of commissions which presents a material conflict of interest with TSA clients.

Regulatory Recommendations:

- Check the revised Form ADV 2A to ensure appropriate language is included regarding receipt of markups and investment management fees and insurance offerings.
- Ensure that the new ADV 2A has adequate language concerning the IARs marking up the bonds in addition to the TSA investment management fee being charged on the same assets.
- Review the Form ADV 2B as well for discussion of additional compensation from insurance sales.

Best Practice Recommendations:

- Consider strengthening the language in the new Form ADV 2A regarding competitive pricing for fixed income issues.

CUSTODY

Findings:

- The policies and procedures for TSA were reviewed in light of the new custody rule.
- The affiliated broker/dealer does not hold client assets, nor receives securities for deposit with the custodian.
- Testing on a spot basis confirmed that clients are receiving custodial statements directly from their account custodian.

No Recommendations

DISASTER RECOVERY/BUSINESS CONTINUITY

Findings:

- The disaster recovery plan was not updated to reflect current employee status.
- The disaster recovery plan was tested in November and there were no issues.

Regulatory Recommendations:

- Update the disaster recovery plan with every change in personnel.

Best Practice Recommendations:

- Consider adding "business continuity" to the Firm's website, listing addresses and phone numbers of relocation, so clients will know how to contact the Firm in case of a disaster.

FEES AND FIRM FINANCIALS

Findings:

- Firm financials were provided for the past three months, including trial balances. The Firm appears to be in a positive net worth position with adequate working capital. There are no long-term liabilities, with the only short-term liabilities being payables for management fee and staff salaries.
- Fee calculations were spot-checked, and there were no issues.

No Recommendations

NEW PRODUCTS OR STRATEGIES LAUNCHED

Findings:

- A new sub-advisor relationship was initiated in 2010, providing TSA with access to equity management for its clients requiring balanced portfolios.

No Recommendations

PRIVACY

Findings:

- Only new clients received TSA's privacy policy in 2010; no clients obtained by TSA in 2009 received the policy in 2010.

Regulatory Recommendations:

- Ensure that all clients receive TSA's privacy policy in 2011, in addition to all new clients obtained in 2011.

PROXY VOTING

Findings:

- TSA does not vote proxies for its clients.

No Recommendations

REGISTRATION AND RENEWALS

Findings:

- TSA paid its state renewal fees as required at the close of 2010 for 2011.

Regulatory Recommendations:

- The SEC is requiring renewal fees with the submission of the ADV 1 amendment in 2011.

RISK ASSESSMENT

Findings:

- A separate risk assessment file is attached.

Best Practice Recommendations:

- Address any medium or high risks.

SERVICE PROVIDER DUE DILIGENCE

Findings:

- Custodian relationships were reviewed in terms of financial stability in the initial quarter of the year.
- The Form ADV Parts 1 and 2 and the sub-advisor agreement for the sub-advisor were reviewed both by TSA personnel and by The Advisor's Resource.

No Recommendations

TESTING

Findings:

- TSA initiated a testing program in 2010, which will be continued on an ongoing basis.

Best Practice Recommendations:

- Increase frequency of best execution testing to quarterly during 2011.
- Review manual sections throughout the year as scheduled on the testing calendar, making necessary changes.

NEW REGULATIONS IN 2010

- New Form ADV 2A and 2B are required to be implemented and distributed to all clients in 2011 by May 31. The new Form 2A will be uploaded to the IARD system by March 31, 2011, with the annual amendment of the Form ADV Part 1.
- Requirements for SEC registration have increased to firms with over \$100 million under management. TSA clearly exceeds this requirement, so will not have to change its registration to the state level.
- Changes to the custody rule were enacted.

NEW REGULATIONS PENDING IN 2011

- Changes to Regulation S-P pertaining to protecting client information and Anti-Money Laundering regulations may be enacted.

- States appear to become more vigilant regarding protection of client private information. Massachusetts and Nevada have passed more stringent privacy rules. It will become increasingly important to monitor such rules in light of TSA clients living out of state.
- The Financial Reform Act is continuing to generate new studies and new proposed rules. It is likely additional rule changes will occur during 2011.

SCOPE OF REVIEW

This was a preliminary compliance review of Tri-Star Advisors, Inc. Due to the time and economic constraints involved, we were unable to look at every file and every document related to TSA's business. We look forward to assisting Ms. Durham to address those areas where we have recommended action.

Sincerely,

Linda A. Shirkey and Jan Huff
The Advisor's Resource, Inc., Your Compliance Partner +

Date: February 15, 2011

A. FIRM OVERVIEW

Tri-Star Advisors, Inc. ("TSA" or "Firm") provides a "managed account service" to individuals and entities wanting portfolio management. TSA also provides its "self-directed retirement plan asset management program" to plan sponsors requiring assistance with managing their retirement plans and educating the plan participants. Both principals of the Firm participate in a local daily live radio show about the market and the economy. The show attracts audience members to free seminars from which many new clients then elect to become clients of Tri-Star Financial ("TSF"), an affiliated broker/dealer.

The Firm was examined by the SEC in April and received its deficiency letter in September. The major concern of the deficiency letter was that TSA was conducting principal trades with clients through TSF, the affiliated broker/dealer.

April was spent mostly producing and organizing the documents in preparation for the SEC examination. After the examination, and particularly after receipt of the deficiency letter, TSA concentrated its efforts on developing a compliant and manageable program for the principal trades enacted with clients through TSF and responding to the letter.

Assets under management increased from \$134,090,502 as of December 31, 2010 to \$150,782,690 as of December 31, 2011.

B. METHOD OF REVIEW

Review conducted by: The Advisor's Resource, Inc. The review was conducted June 1, 2012, and covered the period January 2011 – December 2011.

Method of review and documentation: The Advisor's Resource, Inc. ("TARI") reviewed TSA's books and records, compliance materials and client correspondence for 2011, as required by Rule 206(4)-7 of the Investment Advisers Act of 1940 ("Advisers Act"). The review also included an onsite visit with Ms. Kelly Durham. The materials reviewed by TARI and its findings and recommendations are detailed in this document.

C. CHANGES IN THE REVIEW PERIOD

Business Changes: Principal trades with clients were halted during the year until appropriate disclosure documents and permission were executed.

Legal/Regulatory Changes: The change in AUM requirements for SEC registration has not affected TSA. New regulations address "no pay to play," large trader reporting (13H Filings), and treatment of whistleblowers.

Operational Changes: A procedure was put into place at the close of the year pursuant to Section 206(3) regarding principal trades in fixed income instruments traded through TSF.

Personnel Changes: There were no changes in management.

D. ANNUAL REQUIREMENTS

Requirement	Date
Privacy Policy mailed to clients	5/25/2011
Clients received Form ADV 2A and 2B	5/25/2011
Best execution reviews held and documented	4/12/2011
Form ADV I amended	3/28/2011, 11/29/2011
Revision to Form ADV Part 2	3/7/2011, 11/27/2011
Annual review last conducted	1/25/2011

E. PROGRAM REVIEW

1. GENERAL COMPLIANCE (CENTRAL PROGRAM ELEMENTS)

THE CODE OF ETHICS UPDATES/BREACHES; POLICIES & PROCEDURES MANUAL UPDATES

Findings:

- Changes were made to most of the sections of the manual in November, including the following:
 - Anti-money Laundering: Additional duties of the CCO were articulated.
 - Asset Valuation: Clarification that the custodian's valuation would be used and requiring that pricing changes be reported to the CCO.
 - Books and Records: Retention requirement for principal trading documents was added.
 - Code of Ethics: The personal trading policy was broadened, and all personal trades were required to be enacted through TSF. Language regarding directorships was removed and the gift policy was clarified. Information regarding disciplinary history was added to the personal attestations.
 - Communications and Advertising: Language was added that TSA and/or trade recommendations may not be discussed on the radio program.
 - Communications and Advertising: Due inquiry language was added.
 - Disaster Recovery: CCO duties were added.
 - Intake: Language regarding clients being restricted persons was removed as it was not applicable.
 - Performance: Language concerning aggregating performance numbers was removed.
 - Trading: A full section on principal trades was added, including appropriate forms.
- There were no breaches to the Code of Ethics.
- Access persons submitted annual acknowledgements as required.

Regulatory Recommendations:

- Add pay-to-play and whistleblower language to the Code of Ethics.
- Update the Regulatory Filings section to reflect new requirements for large trades and 13H filings.
- Add a social media policy to Communications and Advertising.
- Add language for trade allocations to include "post-trade" reviews of the allocation, which was identified in the SEC deficiency letter.
- Update Trading section to reflect that cross trades are now allowed.

Best Practice Recommendations:

- Review one to two manual sections each month, noting changes.

CONFLICTS OF INTEREST

Findings

- TSA enacts most of its fixed income trades through TSF, its affiliated broker/dealer. These trades are completed as principal trades by TSF, in which the bonds are marked up before selling to clients or marked down when buying from clients. Trades enacted early in the year were not treated as principal trades meeting the requirements of Section 206(3).
- A full disclosure program was designed and put in place by year-end and included changes to TSA's disclosure document to more accurately disclose the conflict.

Regulatory Recommendations:

- Ensure that the new program is conducted for each trade and is appropriately documented.

Best Practice Recommendations:

- The response letter to the SEC indicates quarterly monitoring will occur to ensure that the program is in place.

CULTURE OF COMPLIANCE (CCO AND STAFF TRAINING)

Findings:

- The CCO originally believed that TSA was not enacting principal trades and recognized immediately prior to the SEC examination that this understanding had been incorrect. She self-reported to the SEC upon the initiation of the examination.
- Following the examination and receipt of the deficiency letter, the principals of the Firm committed considerable resources to address the issue and participated in

many conversations concerning requirements of investment advisors with affiliated broker/dealers.

- The Firm and its management have a much deeper knowledge and respect for the regulations of investment advisors as a result of the examination.
- The CCO attended the NSCP conference in Dallas in April.
- The CCO reads compliance newsletters, articles, etc. and shares the information with staff.
- An annual compliance questionnaire was implemented that addresses U4 updates, private securities transactions, outside brokerage accounts, outside business activities, sales practices, business practices, communications with the public, prohibited practices, and email and internet presence.

Best Practice Recommendations:

- Using the CCO task list in the policies and procedures manual and following the compliance calendar will ensure all compliance tasks are being done in a timely manner.
- Bringing a compliance-related news story to staff meetings on a quarterly basis would help staff better understand the importance of compliance. These stories could focus on persons or firms with SEC enforcement actions. A good place to find these actions is www.sec.gov.
- Consider attending a compliance roundtable in Houston.

PRIVACY (CLIENT AND STAFF)

Findings:

- Laptops and PCs are password protected, and confidential documents are shredded.
- The privacy policy was sent to all clients as required.

No Recommendations

PROGRAM MONITORING

Findings:

- Ongoing monitoring includes daily review of personal trades and client trades and reconciliation of investment holdings in client accounts. Weekly monitoring includes review of portfolio holdings and review of potential investments. Monthly reviews entail reconciliation of client account valuations. Quarterly monitoring includes a detailed review of invoices and performance of client accounts.

No Recommendations

PROGRAM TESTING

Findings:

- Formal testing was conducted on a periodic basis, but not as frequently as the previous year due to the SEC audit.

Best Practice Recommendations:

- Re-engage the testing program using a compliance calendar.

E. PROGRAM REVIEW

2. MARKETING AND FIRM REGISTRATION

ADVERTISING; MARKETING; DISCLOSURE DOCUMENTS; PERFORMANCE

Findings:

- The new ADV2A and 2B were created, uploaded to the IARD system and distributed to clients as required.
- No advertising of TSA occurred in 2011.
- The website was reviewed by the CCO in February to ensure all information was correct and current.
- A new procedure was enacted to prohibit the radio show from mentioning TSA or any specific recommendations or trades.
- Performance reports are computed by Southwest Securities and mailed by the custodian.
- TSA does not report any performance numbers on an account or firm basis.

Regulatory Recommendations:

- Ensure the CCO reviews any marketing material if TSA should begin to advertise.

Best Practice Recommendations:

- Document reviews of the radio show.

REGISTRATION AND RENEWALS

Findings:

- All registrations and renewals were current at the time of the review.

No Recommendations

E. PROGRAM REVIEW

3. CLIENT RELATIONS

ANTI-MONEY LAUNDERING

Findings:

- Southwest Securities, Charles Schwab Institutional and Fidelity Institutional Wealth Services are the custodians responsible for performing anti-money laundering checks on clients. The CCO contacted the custodians in March to ensure AML checks were being conducted.
- There were no red flags for new clients.

No Recommendations

CLIENT AND INVESTOR FILES; COMPLAINTS FROM CLIENTS

Findings:

- There were no client complaints during the review period.
- The 2010 annual review identified the need for an audit of client files to ensure all documents were appropriately executed. This was completed prior to the SEC examination.
- The 2010 annual review recommended that the CCO review all new client documents before any trades would be executed. This was put in place in 2011.
- In April, the CCO reviewed a couple of files to ensure that ongoing suitability documentation is retained.
- No clients terminated during the review period.
- In reviewing some client files, investment objectives were not clear and one file was missing a signature from a principal.

Regulatory Recommendations:

- Ensure all client files have clear investment objectives and suitability noted.
- Review client files every two to three years to ensure investment objectives are up-to-date.
- Ensure all documents in client files have appropriate signatures.

E. PROGRAM REVIEW

4. TRADING AND PORTFOLIO MANAGEMENT

ALLOCATION OF INVESTMENT OPPORTUNITIES; VALUATION; TRADING AND TRADE ERRORS; BEST EXECUTION; CROSS TRADES

Findings:

- The SEC exam uncovered the fact that principal trades were occurring without notifying clients beforehand. Policies and procedures have now been put into place to rectify this situation. Forms were also created to facilitate the process.
- There were no trade errors during the review period.
- No issues had to be fair market valued during the review period.
- The SEC recommended that best execution review be conducted across time, as well as on a trade-by-trade basis.
- The process of enacting cross trades (strictly in order to provide liquidity to clients needing cash) was changed by enacting crosses through the account custodian, which provided the pricing to both sides of the trade.
- In April, the CCO tested a small sample of prices obtained from the custodians with Bloomberg and Fidelity to ensure accuracy of prices. The result was that they were accurate.

Regulatory Recommendations:

- Ensure that best execution reviews are conducted across time as well as on a trade-by-trade basis.
- Clients must be notified and give their consent before principal trades can occur.

SOFT DOLLARS

Findings:

- TSA has no formal soft-dollar arrangements. Additional services provided by Fidelity and Schwab are fully disclosed on the ADV 2A.

No Recommendations

PROXY VOTING

Findings:

- TSA does not vote client securities for clients

No Recommendations

E. PROGRAM REVIEW

5. OPERATIONS

BOOKS AND RECORDS

Findings:

- All documents requested for the review were produced in a timely manner.
- Records are mostly in paper format.

Best Practice Recommendations:

- Consider scanning some files going forward to ease the burden of massive amounts of paper in the future.

CUSTODY

Findings:

- The only manner in which TSA has custody of client assets is through its authority to direct account custodians to deduct its management fees directly from client accounts.
- Employees are prohibited from acting as trustees for client accounts.
- Custodians were contacted to provide the SEC with all client statements and to confirm that statements are sent directly to clients at least quarterly. Each custodian confirmed the mailing of statements and provided requested information to the examiners.
- Custodian reports were reviewed by the CCO in April regarding the safety of client assets, i.e., insurance, etc.

Regulatory Recommendations:

- The due inquiry requirement of custodians was met for 2011 during the examination.

FEES AND FIRM FINANCIALS

Findings:

- The Firm's financials for 2011 indicate a profitable entity with adequate cash reserves and working capital. The only source of income reported was management fees obtained from Southwest Securities, Fidelity and Schwab.
- Fee calculations were checked for a few accounts and there were no issues.

No Recommendations

SERVICE PROVIDER DUE DILIGENCE

Findings:

- Due diligence of service providers was conducted in April 2011. TSA's CCO visited the sub-advisor and determined that 1) the firm's ADV 1 had not been amended since September 2010, missing two annual amendment dates, and 2) the ADV 2A and 2B had not yet been created, distributed or filed by March 30, 2012, as required.
- Charles Schwab Institutional was added as a custodian in 2011.

Best Practice Recommendations:

- Consider putting the sub-advisor on warning that all filings must be brought current. Consider reviewing the sub-advisor's compliance program to ensure the firm is following Texas requirements.

DISASTER RECOVERY/BUSINESS CONTINUITY

Findings:

- The disaster recovery plan was successfully tested and the test was fully documented in April 2011.

No Recommendations

E. PROGRAM REVIEW

6. LEGAL AND RISK MANAGEMENT

REGULATORY FILINGS

Findings:

- The ADV1 with accompanying ADV 2A was filed on the IARD as required before the deadline.
- No additional new regulatory filings are required.

No Recommendations

RISK ASSESSMENT

Findings:

- A risk assessment was completed as part of the Annual Review.

Regulatory Recommendations:

- Ensure that high and medium risks are mitigated if possible in the policies and procedures.

Best Practice Recommendations:

- Consider reviewing and changing the testing schedule to emphasize tests in medium and high risk areas if feasible.

NEW PRODUCTS OR STRATEGIES LAUNCHED

Findings:

- No new strategies or products were launched during the review period.

No Recommendations

F. REGULATORY CHANGES

1. NEW REGULATIONS

- New Form ADV 2A rules require that a Statement of Material Changes be completed for any material changes to the 2A and sent to clients with a written offer in 2012.
- States appear to become more vigilant regarding protection of client private information. Massachusetts and Nevada have passed more stringent privacy rules. It will become increasingly important to monitor such rules in light of TSA clients living out of state.
- The Financial Reform Act is continuing to generate new studies and new proposed rules. It is likely additional rule changes will occur during 2012.

G. SCOPE OF REVIEW

This was a preliminary compliance review of Tri-Star Advisors, Inc. Due to the time and economic constraints involved, we were unable to look at every file and every document related to TSA's business. We look forward to assisting Ms. Durham to address those areas where we have recommended action.

Sincerely,

Linda A. Shirkey and Jan Huff
The Advisor's Resource, Inc., Your Compliance Partner +

Date: June 7, 2012



UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
FORT WORTH REGIONAL OFFICE
19TH FLOOR
801 CHERRY STREET
FORT WORTH, TEXAS 76102

August 31, 2011

Mr. Jon Vaughn
President
Tri-Star Advisors, Inc.
5718 Westheimer, Suite 950
Houston, TX 77057

Re: Examination of Tri-Star Advisors, Inc.
SEC File No. 801-70769

Dear Mr. Vaughn:

The staff conducted an examination of Tri-Star Advisors, Inc. ("Registrant") starting on April 18, 2011, and ending on April 22, 2011. The examination evaluated compliance with certain provisions of the federal securities laws. The examination identified the deficiencies and weaknesses that are described in the attached Examination Findings, and which were discussed with you during an exit interview on April 21, 2011.

The staff is bringing these deficiencies and weaknesses to your attention for immediate corrective action, without regard to any other action(s) that may result from the examination. The deficiencies in the Examination Findings are based on the staff's examination and are not findings or conclusions of the Commission. You should not assume that the firm's activities discussed in the Examination Findings do not constitute deficiencies or weaknesses under any other federal securities law or other applicable rules and regulations not discussed above or that the firm's activities not discussed in the Examination Findings are in full compliance with federal securities laws or other applicable rules and regulations.

Note that the descriptions of the law and related interpretations in the Examination Findings may be paraphrased or abbreviated. Go to our website at <http://www.sec.gov/divisions.shtml> for complete information related to these regulatory requirements.

Please respond in writing to each of the matters described in the Examination Findings within thirty days of the date of this letter, describing the steps you have taken or intend to take with respect to each of these matters. Please respond directly to this office as follows:

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TSA-DOE 0002234

Karyn Mysliwicz, Branch Chief
U. S. Securities and Exchange Commission
Fort Worth Regional Office
801 Cherry Street, 19th Floor
Fort Worth, TX 76102

In addition, a copy of your reply, together with copies of any enclosures, should be sent to the following person(s):

John Sweeney
U.S. Securities and Exchange Commission
Office of Compliance Inspections and Examinations
100 F Street, NE
Mail Stop 7030
Washington, DC 20549

Thank you for your cooperation. If you have any questions, please contact me at (817) 900-2611 or Karyn Mysliwicz at (817) 900-2637.

Sincerely,
Donna C. Esau
Assistant Regional Director
Examinations

By: 
Frances From
Staff Accountant

Attachment: Examination Findings

APP. 0031

TSA-DOE 0002235

EXAMINATION FINDINGS

Tri-Star Advisors, Inc.
(SEC File No. 801-70769)

I. Principal Trading – Section 206(3)

Investment Advisers Act of 1940 (“Advisers Act”) Section 206(3) prohibits an investment adviser from “acting as principal for his own account, knowingly to sell any security or to purchase any security from a client ... without disclosing to such client in writing before the completion of such transaction the capacity in which he is acting and obtaining the consent of the client to such transaction.” Furthermore, the notification and consent requirements set forth in Section 206(3) also must be complied with when an affiliated broker-dealer under common control with the investment adviser engages in principal trades with the advisory client.

Registrant engaged in numerous principal trades with clients effected through its affiliated broker-dealer, Tri-Star Financial AKA Mutual Money Investments, Inc. Trades were processed in this manner routinely in violation of Section 206(3). Registrant’s affiliated broker-dealer earned approximately \$1.2 million in sales credits on principal trades during the examination period. Registrant’s conduct is not consistent with the requirements of Section 206(3).

II. Compliance Policies and Procedures – Rule 206(4)-7

Rule 206(4)-7 under the Advisers Act requires advisers to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act. Each adviser should identify conflicts and other compliance factors creating risk exposure for the firm and its clients in light of the firm’s particular operations, and then design policies and procedures that address those risks.

Registrant has adopted a compliance manual (“Manual”); however, the Manual contains procedures for areas that are not applicable to Registrant’s operations and the manual does not contain other needed procedures. For example, the Manual included procedures for allocation of block trades but does not include provisions for post-trade review of the allocation. In addition, procedures are included that describe best execution but do not include provisions for review over a period of time. In addition, Registrant does not have procedures addressing principal trading. Registrant’s Manual is not reasonably designed to prevent violations of the Advisers Act.

III. Code of Ethics – Rule 204A-1

Rule 204A-1 under the Advisers Act requires registered investment advisers to establish, maintain and enforce a written code of ethics containing policies and procedures relating to, among other things, personal securities transactions.

While Registrant has adopted a code of ethics (“Code”), the examination found Registrant’s access persons had not submitted annual acknowledgements as required. In addition, Registrant needs to expand the list of persons considered access persons as most employees have access to trading information. Registrant’s conduct is inconsistent with the requirements of Rule 204A-1.

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TSA-DOE 0002236

EXAMINATION FINDINGS
Tri-Star Advisors, Inc.
(SEC File No. 801-70769)

IV. Best Execution – Section 206

Section 206, the anti-fraud provision of the Advisers Act, imposes a fiduciary duty on investment advisers. As such, an adviser has an obligation to act in the best interest of its clients and to place their interests before its own. The Commission has indicated that among the specific obligations that flow from an adviser's fiduciary duty is the requirement to obtain the best price and execution of client securities transactions where the adviser is in a position to direct brokerage transactions.

Registrant conducts a trade by trade review of quality of execution but does not review for quality of execution over time or a broad cross section of trades. Registrant's failure to conduct these types of reviews is not consistent with its fiduciary duty.

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TSA-DOE 0002237



UNITED STATES
 SECURITIES AND EXCHANGE COMMISSION
 FORT WORTH REGIONAL OFFICE
 801 CHERRY STREET
 SUITE 1900
 FORT WORTH, TEXAS 76102
 PHONE: (817) 978-3821 FAX: (817) 978-2700

IN REPLYING
 PLEASE QUOTE

Examination Receipt

(I) (We) hereby acknowledge receipt of SEC Form 1661 (5-04), "Supplemental Information for Regulated Entities Directed to Supply Information Other Than Pursuant to a Commission Subpoena" and SEC Form 2389 (11-07), "Examination Information for Broker-Dealers, Transfer Agents, Clearing Agencies, Investment Advisers and Investment Companies"

from Frances From

on 4/20/2011

Registrant Tri-Star Advisors, Inc.

File No. 801-70769

5718 Westheimer Suite 950
 Street Address

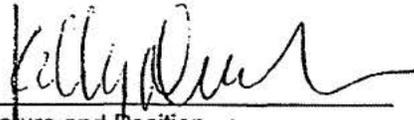
Houston

City,

TX 77057

State, Zip Code

(713) 735-9200
 Telephone Number

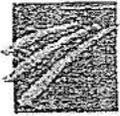

 Signature and Position CCO

 Signature and Position

 Signature and Position

 Signature and Position

APP. 0034



November 29, 2011

Karen Mysliwicz, Branch Chief
US Securities and Exchange Commission
Fort Worth Regional Office
801 Cherry Street, 19th Floor
Fort Worth, TX 76102

Re: Examination of Tri-Star Advisors Inc.
SEC File No. 801-70769

Dear Ms. Mysliwicz:

We are responding to your letter of August 31, 2011, regarding the above examination. For your convenience, we are responding to the items in the order in which they are addressed in your letter. Your language (in pertinent part) is shown in *italics*.

I. Principal Trading – Section 206(3)

Registrant engaged in numerous principal trades with clients effected through its affiliated broker/dealer, Tri-Star Financial AKA Mutual Money Investments, Inc. Trades were processed in this manner routinely in violation of Section 206(3).

Our Investment Advisor History

Tri-Star Advisors Inc. ("TSA") was created in response to 1) our concerns regarding the developments affecting the fee-based brokerage account industry as a result of the U.S. Circuit Court of Appeals (D.C.) vacating the rule under the Investment Advisers Act of 1940 ("the Act") that had previously exempted certain broker/dealers offering fee-based accounts from registration under the Advisers Act; and 2) identified client needs in the area of investment discretionary services. Prior to that time period, principals of what would later become TSA were primarily engaged in the broker/dealer business through Tri-Star Financial, Inc. as described in more detail below.

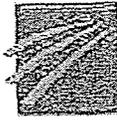
Tri-Star Financial, AKA Mutual Money Investments, Inc. ("TSF") was established as a registered broker/dealer by Bill Payne in 1993 as a fully disclosed introducing broker/dealer which cleared through Southwest Securities, Inc. TSF was established to build a company under local management with an expertise in trading to provide clients with access to mortgage-backed securities. Later John Bott and I joined the firm as principals.

While TSF (when acting as a dealer) has engaged in principal transactions involving markups and markdowns for its brokerage account clients, the firm has done so almost exclusively on a riskless principal basis. TSF has obtained bonds in its account in order to provide appropriate investment vehicles for its clients. Rarely, if ever, has TSF traded solely for its own account. Our financials indicate that proprietary trading is not a focus of the firm's operation. We estimate that at least 95% of the transactions enacted by the firm in its history have been riskless principal transactions rather than market making.

As time went on, it became clear to clients that TSF was providing access to attractive securities which were not readily available on a retail level through the wire houses. This investment niche (CMOs, or

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TRI-STAR ADVISORS



collateralized mortgage obligations) became more complicated and less available and required substantial research in order to understand the underlying risks and to source these difficult-to-find securities at a good price. Certain clients wanted their advisors to be able to take discretion, placing trades in client accounts without receiving a particular order from a client, as some clients travel extensively and did not want to miss investment opportunities. (Securities which are attractive in this niche take considerable time to source and are generally not available for long.) TSF does not allow its registered representatives to exercise investment discretion.

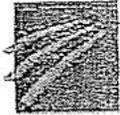
In its 18-year history of operations, TSF has not experienced much client turnover, regulatory and/or client concerns or complaints. In keeping with the firm's high regard for regulatory compliance and fair dealings in general, the few such concerns that have arisen have all been properly, effectively and expeditiously addressed by senior management of the firm. Mr. Payne and I launched Tri-Star Advisors ("TSA" or the "Firm"), a separate registered investment advisory corporation, in 2009 in order to meet this identified client need and to offer discretionary investment advice on an ongoing fee basis in a manner consistent with the existing and evolving regulatory environment.

Most advisory clients of TSA were existing TSF clients that had been serviced by the now principals of TSA when they were acting in their capacities as registered representatives. The appeal to TSA for these clients has continued to be the principals' proprietary ability to source specialized fixed income securities, the clients' personal investment relationship, knowledge and experience with the principals of the firm initially gained through TSA's affiliated broker/dealer. Mr. Payne and I have been specific in our discussions with clients and potential clients that fixed income securities placed in TSA client accounts would continue to be obtained through TSF and would be charged both an investment advisory fee (through TSA) and a markup or markdown on each transaction (through TSF). However, at no time in its history has TSA (as a separate investment advisory entity) ever traded for or maintained its own proprietary investment account. For these reasons and others we believed our clients' understanding and our written and spoken disclosures to our advisory clients were thorough, appropriate and accurate based on our understanding of applicable regulatory requirements.

Compliance has clearly been a priority for TSA since its inception. The Firm's designated CCO is competent and knowledgeable regarding the Act and has attended various training programs, and the Firm has retained a reputable compliance consultant from the beginning of its operations. The Firm fully disclosed its relationship with TSF and the conflicts of interest therein to all clients from the beginning. It was never the intent of the Firm to fail to meet any regulatory requirements. While the principals of TSA were aware of the federal laws, regulations, rules and SRO requirements applicable to broker/dealers engaged in principal ("dealer") transactions relating to client trading in brokerage accounts, we fully believed that TSA was not engaged in principal transactions regarding our advisory clients. This belief was based on the fact that TSA has never owned a proprietary trading account as a separate legal entity.

In the week prior to our SEC examination, we recognized that we should reconsider the principal trading requirements in light of our operation. (Our CCO attended a regional National Society of Compliance Professionals meeting on April 11, 2011, where principal trading through an affiliated broker-dealer was discussed.) The following week, at the initial meeting with the SEC examiners, we volunteered that we had only recently learned that our affiliation with TSF might require additional compliance procedures. We turned to the examiners for assistance in determining if we would need to change our current processes. We voluntarily raised this issue with the examiners at the onset of the examination in an effort to be forthcoming and to demonstrate our intent to follow all requirements. We also expressed

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our concern and desire to repair any possible unintentional oversight. To this end, we appreciate having been granted an extension to the deadline for filing this response letter in order for us to fully implement corrective policies, procedures and disclosures.

TSA had only been registered for less than two years at the time of this examination. This was our first examination, and we viewed it as an opportunity to educate ourselves as to any additional requirements and to strengthen our program as appropriate. We clearly knew and have followed the major rules: we have (i) had a competent, onsite and knowledgeable Chief Compliance Officer ("CCO") on staff, (ii) created and followed customized policies and procedures, (iii) created written annual reviews, (iv) filed our amendments as required and (v) created a plain English Form ADV which fully discloses our relationship to TSF. Our prior understanding of the somewhat esoteric principal transaction requirements was in terms of proprietary trades of TSA. We believed we were following the requirements with our extensive and timely disclosures. We made no effort to conceal the conflict or the common control of TSA and TSF resulting from Mr. Payne's controlling ownership interest in these firms.

Corrective Actions Already Taken

We obviously want to follow and be in compliance with the applicable regulatory requirements regarding principal transactions. In furtherance of that goal, we have already implemented the following policies and procedures regarding TSA's principal transactions.

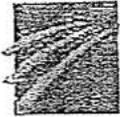
First, we have developed, implemented and are currently using new written disclosure notice documents (both pre- and post-execution) which are being delivered to advisory clients on a transaction-by-transaction basis for each principal transaction being considered for execution, or that has been executed, on behalf of any of our advisory client accounts. Additionally, we are also obtaining each client's consent authorizing us to proceed with the transaction before the settlement date of each such principal transaction. Our adopted and implemented principal transaction procedures allow the Firm to deliver the required written disclosure notice in hard copy (postal delivery) or in electronic email format for those advisory clients that have completed our email disclosure and consent forms. Our procedures also permit us to accept advisory client consent to such transactions either verbally, by email or by other written form. When client consent is obtained verbally, our procedures require written documentation of the manner and date of the received client consent. Our written disclosure notice documents also advise our clients that absent their consent (which can be withheld at any time) they will not participate in a particular principal transaction. Please see Attachments A, B, C and D which are copies of the required forms. These forms are currently in use.

Second, we have recently amended and filed onto the IARD system our amended Forms ADV Parts 1 and 2A to accurately reflect and disclose the Firm's principal transactions business practices and operations. Please see Attachments E and F for copies of the revised disclosure documents.

Third, we have reviewed and amended our Policies and Procedures Manual to accurately reflect this practice and to outline our required procedures. Please see Attachment G for the revised sections of the manual. Please see the section titled Trading for the revised section on principal trades. These practices have been fully implemented.

Fourth, we have amended our advisory client agreement to more accurately reflect the Firm's principal transactions policies and procedures. Please see Attachment H for the revised version.

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Fifth, we have reviewed the changes with all TSA personnel to discuss the procedures both before and after initial implementation to ensure that all steps and documents are fully understood and are being implemented correctly, and that personnel are comfortable answering clients' questions. There have been no questions or concerns expressed by our advisory clients since implementation. Please see Attachment I documenting the subject matter of our personnel training sessions and the attendance of employees participating in the training session(s).

And finally, we have designed a testing program to ensure on an ongoing basis that this change continues to be in effect. For 2012, our CCO (or an outside consultant hired by the Firm) will monitor compliance with these new procedures on a quarterly basis. The monitoring will culminate in a written report of the review findings which will be given directly to the Firm's senior management. Based on the written report, senior management will oversee remedial actions deemed appropriate. For 2013, the CCO (or outside consultant) will monitor compliance with the Firm's principal transactions procedures on a semi-annual basis providing a written report of the review findings to senior management for any corrective actions. In all subsequent years, the CCO or outside consultant will conduct this review on an annual basis, reporting the findings to senior management.

Clients Have Not Been Harmed

We now certainly understand and agree with the need for the required disclosures when an investment advisor trades through its affiliated broker/dealer on a riskless principal transaction basis.

As the examiners saw during their examination of our books and records, as well as through interviews, TSA experienced no client complaints and lost no clients during the examination period. Performance of client accounts on a composite basis (including all TSA client accounts for which third party performance figures exist over the full examination period, giving each account equal weight regardless of dollar value) during 2010 was 10.71% net of fees (and markups) and was 1.51% for the first quarter of 2011. In comparison, the performance of Barclay's MBS Index, comprised of mortgage-backed securities (the closest index to our strategy) was 5.23% for 2010 and 0.60% for the first quarter of 2011. We believe these performance comparisons clearly indicate that the execution costs associated with the principal transactions effected on behalf of our clients during the review period had no negative impact on client account performance.

As part of our complete review after receipt of your letter, we have also calculated the markups to clients during the examination period. We believe the sales credit number in your letter is materially overstated and may reflect the inclusion of cancelled/rebilled transactions, resulting in counting some markups twice, as well as the inclusion of transactions conducted for TSF clients prior to their entering an advisory relationship with TSA.

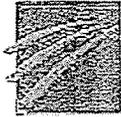
For all the reasons stated above, we believe we currently are in compliance with the requirements of Section 206(3) and will continue to be in the future.

II. Compliance Policies and Procedures – Rule 206(4)-7

The manual contains procedures for areas that are not applicable to Registrant's operations and the manual does not contain other needed procedures....

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TRI-STAR
ADVISORS



As a result of your letter, we have conducted a full review of all of our documents, practices and written procedures. As a result, we have revised our policies and procedures manual to more completely reflect our current practices. We have attached the revised manual sections as Exhibit G.

III. Code of Ethics

Registrant's access persons had not submitted annual acknowledgements [of the Code of Ethics] as required.

During the examination, we provided the examiners with all employee acknowledgements of the 2010 Tri-Star Financial Code of Ethics (please see Attachment J) and the 2011 employee acknowledgements for Tri-Star Advisors Code of Ethics (see Attachment K). Since the receipt of the deficiency letter, we have located the 2010 Tri-Star Advisors employee acknowledgements for the Code of Ethics. These documents had been misfiled by a compliance associate who had been ill during late 2009 and early 2010 and were only recently located. Please see Attachment L.

IV. Best Execution – Section 206

Registrant...does not review for quality of execution over time or a broad cross section of trades.

Please see the revised procedures for monitoring best execution in the revised Trading section of the Policies and Procedures Manual, Attachment G.

We appreciate your comments and the courtesy granted us by the examiners. We hope that you find this letter and the attachments responsive to all of the concerns raised in your letter. We also hope that our response clearly demonstrates our commitment to meeting all applicable regulatory requirements and acting in the best interests of our advisory clients. Please contact us with any questions or comments.

Sincerely yours,

A handwritten signature in black ink, appearing to read "Jon C. Vaughan".

Jon C. Vaughan, President

Attachments:

- A. Client Principal Transaction Disclosure and Consent Form (Pre-execution)
- B. Client Principal Transaction Disclosure and Consent Form (Post-execution)
- C. Client Consent Confirmation Notice
- D. Email Consent Form
- E. Amended Form ADV 1
- F. Amended Form ADV 2A
- G. Revised Policies and Procedures Manual
- H. Amended Investment Advisory Agreement
- I. Principal Trading Training and Sign-in Sheet
- J. Tri-Star Financial 2010 Code of Ethics Acknowledgements
- K. Tri-Star Advisors 2011 Code of Ethics Acknowledgements
- L. Tri-Star Advisors 2010 Code of Ethics Acknowledgements

APP. 0039

Page 1

1 UNITED STATES SECURITIES AND EXCHANGE COMMISSION
 2
 3 In the Matter of:)
 4) File No. FW-03686-A
 5 PARALLAX INVESTMENTS, INC.)
 6
 7 WITNESS: Jon Carter Vaughan
 8 PAGES: 1 through 69
 9 PLACE: Texas State Securities Board
 10 1919 North Loop West, Ste. 300
 11 Houston, Texas
 12 DATE: Thursday, August 16, 2012
 13
 14 The above-entitled matter came on for hearing,
 15 pursuant to notice, at 1:12 p.m.
 16
 17
 18
 19
 20
 21
 22
 23
 24 Diversified Reporting Services, Inc.
 25 (202) 467-9200

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1 APPEARANCES:
 2
 3 On behalf of the Securities and Exchange Commission:
 4 JOANN HARRIS, ESQ.
 5 BARBARA GUNN, ESQ.
 6 Division of Enforcement
 7 Securities and Exchange Commission
 8 801 Cherry Street, Unit 18
 9 Fort Worth, Texas 76102
 10 817-978-6467
 11
 12 On behalf of the Witness:
 13 ROY WASHINGTON, ESQ.
 14 18115 Heaton Drive
 15 Houston, Texas 77084
 16 281-859-6774
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1 C O N T E N T S
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 3 WITNESSES EXAMINATION
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 6 E X H I B I T S
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1 P R O C E E D I N G S
 2 MS. HARRIS: We're on the record at 1:12 p.m.
 3 on August 16, 2012.
 4 Please raise your right hand.
 5 Whereupon,
 6 J O N C A R T E R V A U G H A N
 7 having been first duly sworn, was called as a witness
 8 herein and was examined and testified as follows:
 9 E X A M I N A T I O N
 10 BY MS. HARRIS:
 11 Q Do you understand that you will remain under
 12 oath throughout these proceedings today?
 13 A Yes, ma'am.
 14 Q And if you would, please state and spell your
 15 full name for the record.
 16 A First name is Jon, J-O-N, middle name is
 17 Carter, C-A-R-T-E-R, last name is Vaughan, V-A-U-G-H-A-N.
 18 Q Thank you. We've met informally off the
 19 record, but again, my name is Joann Harris. I'm an
 20 attorney for the SEC's Forth Worth office. Joining me
 21 today, who you also met, and she's not in the room at the
 22 moment, is Barbara Gunn. She's an assistant regional
 23 director, also in the Fort Worth office. And for
 24 purposes of today's proceeding, we are both officers of
 25 the United States Securities and Exchange Commission.

1 examiners?
 2 A Yes, ma'am.
 3 Q And what do you remember from your discussions
 4 about that?
 5 A I remember that it was a little confusing at
 6 the time because coming from the broker-dealer side,
 7 principal trading always meant having a proprietary
 8 brokerage account. Now, we don't really trade for our
 9 own account at Tri-Star Financial, but just having that
 10 account meant if bonds come in and hit that account and
 11 then you mark them up, that's a principal transaction.
 12 And so on the Tri-Star Advisor side that
 13 question came up: Are you principal trading? Which I
 14 believe we said we don't think we're principal trading
 15 because Tri-Star Advisors doesn't have a trading account.
 16 We have an omnibus allocation account, but we didn't have
 17 any principal trading account.
 18 And I'm not sure if it was before or after
 19 that, I know Kelly Durham, our CCO, had gone to SEC
 20 conference -- I don't remember if it was a week before or
 21 a week after, but sometime in there --
 22 Q Around the examination?
 23 A Around the examination -- that she came back
 24 and said, There's something funny here with the principal
 25 trading and we need to kind of look into it a little

1 the years about compliance issues with respect to
 2 Tri-Star Advisors?
 3 A Yes, ma'am. We try to get together -- well,
 4 it's only now three years in, but it seemed like we did a
 5 semiannual or annual review just to kind of talk about
 6 the changes in the rules and the regs, what we needed to
 7 be aware of. Now, we've been in more communication with
 8 her lately, obviously, regarding the rule 206(3), the
 9 principal trading rule.
 10 Q Did you ask Ms. Shirkey how come she hadn't
 11 caught this earlier?
 12 A Yes, ma'am, I did.
 13 Q What did she say?
 14 A She said the rule was stated there kind of
 15 under the same assumption that without a proprietary
 16 trading account, and it was sort of a subset of that, the
 17 control interest factor, and that was one that I can
 18 understand can be overlooked but makes me wonder do I
 19 need to have two compliance consultants. But we caught
 20 it, we corrected it, and so I feel confident now that we
 21 won't have any sort of oversights on those things.
 22 Q Okay. Well, just to give you a little bit of
 23 context, I understand that post SEC examination, Tri-Star
 24 Advisors and Tri-Star Financial has changed its process a
 25 bit on how it actually brings in these CMOs and handles

1 more. And we have our outside compliance consultant that
 2 we hired from day one to get everything right. We
 3 contacted her after your initial examination and we sort
 4 of delved into a little bit more, and that was the point
 5 where we said, Okay, this may be principal trading, not
 6 because we have an account but because Bill has ownership
 7 of an affiliated dealer. So that was when we kind of
 8 became aware of the situation.
 9 Q So the first time that you became aware of a
 10 potential issue involving principal trading and Section
 11 206(3) was at or around the time of the SEC examination
 12 and when Ms. Durham went to that conference.
 13 A Yes, ma'am. Because she came back and said,
 14 We're going to need to look into this rule a little bit
 15 more. Because there's some subsets of it that, quite
 16 frankly, our compliance consultant didn't catch, and so
 17 we investigated it more.
 18 Q Who is that outside compliance consultant?
 19 A Linda Shirkey. And I apologize, I don't
 20 remember the name of her company.
 21 Q I understand her firm that she works with,
 22 owns, I'm not sure exactly, is Advisor's Resource. Does
 23 that sound right?
 24 A That sounds right, yes, ma'am.
 25 Q Have you personally met with Ms. Shirkey over

1 the markets. Is that also your understanding?
 2 A Yes, ma'am. We changed it, I think, in the
 3 summertime, maybe, of last year.
 4 Q Well, I'd like to ask you, if you could, I want
 5 to focus on the time period with the old process as to
 6 how it was, and I want to understand a little bit, if you
 7 had an understanding at the time, exactly what was it
 8 that was happening that was a potential violation of
 9 206(3), like what was the old process.
 10 A I'm sorry. Ask me that again.
 11 Q Well, let me start over. Why don't you walk me
 12 through how CMOs for Tri-Star Advisory clients, if
 13 they're being bought through Tri-Star Financial, how were
 14 those processed internally that potentially, I think,
 15 gave rise to this principal trade issue.
 16 A I understand. Initially when we would buy a
 17 bond from the street, it would come into Tri-Star
 18 Financial's inventory account.
 19 Q Is that the 604 account?
 20 A Yes, ma'am. Okay, so you're familiar with
 21 these terms. So the 604 account, and then it would be
 22 marked up and sent to the TSA omnibus allocation account.
 23 And our understanding was, because we had no proprietary
 24 account for TSA, there wasn't a principal trade issue
 25 there because we weren't putting into a trading account

1 at TSA and marking it from there. Tri-Star Financial was
2 making the markup and TSA was not. So that was our
3 understanding, so that was the old way of how it would
4 come into the account.

5 The new way, not so much in response to
6 principal trading, but also to the fact that for years
7 our Tri-Star Financial never marked up bonds to the
8 brokerage houses -- or to broker. The trading desk --
9 excuse me -- didn't mark up bonds to the brokers. And
10 last year, as well, simultaneous to the principal trading
11 issue, but we also had FINRA coming in and putting CMOs
12 on TRACE, right, so for pricing purposes they're trying
13 to --

14 Q What's TRACE?

15 A TRACE is a price reporting system that's
16 already implemented for corporate bonds, and FINRA's
17 trying to do that in the -- for mortgage securities.
18 Now, they have not disseminated any of that information.
19 I think they're still kind of beta-testing this thing as
20 far as I understand.

21 But at that point we said, Well, if we're going
22 to be bringing bonds to Tri-Star Financial's account, the
23 broker needs like to have a profit center like every
24 other broker in the United States does, where they take a
25 mark to pay for operations, traders, and all of those

1 to use this as an example: 99 cents, which would be
2 where Tri-Star Financial bought the bonds, and then the
3 actual price paid would be par or 100, which the client
4 has paid -- the advisory client. And on \$100,000, that
5 equates to \$1000.

6 We show markup/markdown. I put in there \$1000.
7 I email it to my advisory clients. They have to consent
8 back to that that trade is acceptable before settlement.
9 If they don't, the trade gets canceled and it gets
10 allocated away to somebody else.

11 And so they have to consent back after seeing
12 all the full disclosure, and we implemented that -- I
13 think I kicked that off with my people back in October,
14 and I didn't have any issue. Everybody's fine with it;
15 they continue on.

16 Q So I take it that this -- the new procedures
17 getting the client's consent to these markups -- it
18 sounds like that process, at least as far as you're
19 concerned, seems to be working pretty well?

20 A Yes, ma'am. There's a little discontent from
21 my clients who --

22 Q Like what?

23 A You know, the reason they wanted to move to the
24 advisory, so I didn't have to get permission every time,
25 and now I'm still having to get permission. But in the

1 things before it moves off to the brokerage side of the
2 account.

3 Q So are there any -- under the new process are
4 there any additional steps like disclosures consents
5 that -- for advisory clients that folks at Tri-Star
6 Advisors has to go through now to get a markup on a CMO?

7 A Yes, ma'am.

8 Q Can you walk me through what you understand
9 those to be.

10 A Yes, ma'am. With the help of Roy and Linda, we
11 went through and drafted a document you may have seen,
12 and it's a consent form, and what we disclose on that for
13 our advisory clients, if I buy a bond through Tri-Star
14 Financial, okay? -- and in order to be a principal -- it
15 doesn't matter; it's a principal trade if it touches
16 Tri-Star for a nanosecond, so --

17 Q Tri-Star Financial.

18 A Tri-Star Financial for a nanosecond it's a
19 principal trade, and we recognize that. So what -- the
20 process we changed was we created the document -- Linda
21 and Roy did, technically, that discloses very clearly,
22 here's the security description; here is the best --
23 the -- whether we bought or sold, the best price
24 available, the actual price paid, so the best price
25 available would be disclosed in there, and I'm just going

1 bond market we're not trading all day every day like a
2 stock kind of thing. We may buy one bond a month; you
3 know, two bonds a month.

4 So for the most part it's not impacting my
5 clients overly, because I send them one email.
6 Settlement day on bonds is usually a week or two weeks
7 out, so -- and I know most of the time if they're on
8 vacation; anymore they get emails -- everybody with
9 technology, they get email.

10 So a little discontent, but most of them
11 understand the process. I was very clear about the
12 issue. I said, Here's the problem. You know, I'm an
13 owner of Tri-Star Financial and also of TSA, which we
14 disclose in all of our initial meetings with clients.

15 In the asset management agreement it's stated
16 in there in all of those things, and we go over that
17 verbally that I'm an owner of both; I'm going to be
18 compensated both sides, you know.

19 And so we go over that, so they're aware of it.
20 Nobody's really had any issue other than I've had to
21 cancel one trade, and the guy was on vacation. He was a
22 little angry about that.

23 I said, Well, I apologize; that's just -- we'll
24 get you the next bond.

25 Q Right. I'm handing you a document that's been

PROOFREADER'S CERTIFICATE

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In The Matter of: PARALLAX INVESTMENTS, LLC

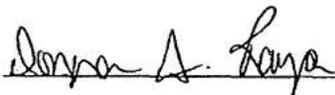
Witness: Jon Carter Vaughan

File Number: FW-03686-A

Date: Wednesday, August 16, 2012

Location: Houston, TX

This is to certify that I, Donna S. Raya,
(the undersigned), do hereby swear and affirm that the
attached proceedings before the U.S. Securities and
Exchange Commission were held according to the record and
that this is the original, complete, true and accurate
transcript that has been compared to the reporting or
recording accomplished at the hearing.



8/22/12

(Proofreader's Name)

(Date)

CERTIFICATE OF REPORTER

1
2 I, Leslie Berridge, hereby certify that the foregoing
3 transcript consisting of 7 pages is a complete, true, and
4 accurate transcript of the investigative hearing indicated,
5 held on August 16, 2012, at Houston, Texas, in Parallax
6 Investments, LLC. I further certify that this proceeding was
7 recorded by me, and that the foregoing transcript has been
8 prepared by me or under my direction.

Leslie Berridge

Official Reporter

1 UNITED STATES SECURITIES AND EXCHANGE COMMISSION
 2
 3 In the Matter of:)
 4) File No. FW-03686-A
 5 PARALLAX INVESTMENTS, INC.)
 6
 7 WITNESS: William Thomas Payne
 8 PAGES: 1 through 134
 9 PLACE: Texas State Securities Board
 10 1919 North Loop West, Ste. 300
 11 Houston, Texas
 12 DATE: Thursday, August 16, 2012
 13
 14 The above-entitled matter came on for hearing,
 15 pursuant to notice, at 9:09 a.m.
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 24 Diversified Reporting Services, Inc.
 25 (202) 467-9200

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1 APPEARANCES:
 2
 3 On behalf of the Securities and Exchange Commission:
 4 JOANN HARRIS, ESQ.
 5 BARBARA GUNN, ESQ.
 6 Division of Enforcement
 7 Securities and Exchange Commission
 8 801 Cherry Street, Unit 18
 9 Fort Worth, Texas 76102
 10 817-978-6467
 11
 12 On behalf of the Witness:
 13 ROY WASHINGTON, ESQ.
 14 18115 Heaton Drive
 15 Houston, Texas 77084
 16 281-859-6774
 17
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1 PROCEEDINGS
 2 MS. HARRIS: Let's go on the record at
 3 9:09 a.m. on August 16, 2012. Please raise your right
 4 hand.
 5 Whereupon,
 6 WILLIAM THOMAS PAYNE
 7 having been first duly sworn, was called as a witness
 8 herein and was examined and testified as follows:
 9 EXAMINATION
 10 BY MS. HARRIS:
 11 Q Do you understand that you'll remain under oath
 12 throughout these proceedings here today?
 13 A Yes.
 14 Q Okay. If you would please state and spell your
 15 full name for the record.
 16 A William Thomas Payne, P-A-Y-N-E.
 17 Q We've met informally off the record, but,
 18 again, my name is Joann Harris. I'm an attorney with the
 19 SEC's Fort Worth regional office. Joining me today is
 20 Barbara Gunn. She's an assistant regional director also
 21 in the Fort Worth office. We are both officers of the
 22 United States Securities and Exchange Commission for
 23 purposes of this proceeding.
 24 This is an investigation by the United States
 25 Securities and Exchange Commission in the matter of

1 still running Mutual Money Desk.
 2 Q And why did you seek to get your -- to get
 3 registered as a broker?
 4 A To get better at what I did.
 5 Q So I guess at that point in time were you
 6 anticipating selling other things besides CDS?
 7 A Yes, I was.
 8 Q So, again -- you might have already said
 9 this -- but what Securities Money do? Is it a registered
 10 broker-dealer?
 11 A It's a registered broker-dealer. It's what you
 12 would call a discount broker-dealer so that you go there
 13 to get your license. And you basically hang your license
 14 there and you pay them a fee -- a monthly fee -- and get
 15 a high payout.
 16 Q Are they still in business?
 17 A Yes, they are. They're out of Omaha, Nebraska.
 18 Q All right. Again, we're going to have some
 19 overlapping time periods. But now it looks like we're
 20 getting to the Tri-Star Financial time period. So why
 21 don't you kind of walk us through -- I guess it's the
 22 1992 time frame based on the dates in your employment
 23 history here. So tell me about Tri-Star Financial.
 24 A So I wanted to start a broker-dealer. When I
 25 first went to a consultant to find out about getting a

1 are?
 2 A John Bott, B-O-T-T, owns 40 percent, I own 40
 3 percent, and Jon Vaughan owns 20 percent --
 4 V-A-U-G-H-A-N.
 5 Q And at point in time since you've started
 6 Tri-Star Financial did Mr. Bott enter the picture and
 7 why?
 8 A In 1995 John Bott introduced me to what are
 9 called CMOs, or collateralized mortgage obligations. He
 10 brought a lot to the table. And I had just gotten
 11 through a lot of hard times with a guy by the name of
 12 Gary Morris, and John Bott had been in the industry for
 13 over 20 years. He made a very good partner.
 14 Q At the time in 1994 approximately when Mr. Bott
 15 joined you at Tri-Star Financial were you 50/50 owners at
 16 that time?
 17 A No, we were not. When John Bott came on
 18 Tri-Star he was strictly an employee.
 19 Q Okay. When did Mr. Bott obtain his ownership
 20 in Tri-Star financial?
 21 A I believe it was in 1995.
 22 Q And you mentioned Mr. Vaughan who owns 20
 23 percent of the firm. When -- who is that and when did he
 24 enter the picture?
 25 A He was also an employee -- came on actually in

1 broker-dealer it was almost impossible to start a
 2 broker-dealer with a company that was already in business
 3 because you'd have to go back and do all the financial
 4 records and everything else. It was easier to close one
 5 and reopen up another one. So we closed Mutual Money
 6 Desk and I started a company that's actually called
 7 Mutual Money Investments. I changed the name -- or
 8 d/b/a'd the name later on.
 9 Q To Tri-Star Financial.
 10 A To Tri-Star Financial. When I did close the
 11 company one of the people that worked for me started a
 12 company that was called Mutual Money Desk Securities and
 13 put his own shingle, so to speak. And I did not want
 14 them to be related to us so, therefore, I changed the
 15 name to d/b/a Tri-Star Financial.
 16 Q Are you the sole founder of Tri-Star Financial?
 17 A I did have a -- I had some small people come in
 18 and help me, but they were all minority shareholders.
 19 One of them was a gentleman by the name of Gary Morris.
 20 Q This the same Gary Morris that we talked about
 21 earlier with respect to his wife?
 22 A Yes.
 23 Q Are you the sole owner of Tri-Star Financial?
 24 A I am not.
 25 Q Okay. Can you tell me who the other owners

1 also 1994. I wish my memory would tell me exactly what
 2 date he became a stockholder. I'll bet you that he can
 3 and he's next.
 4 Q What do you do currently at Tri-Star Financial
 5 in the role of president? What does that mean you do?
 6 A Basically watch over the financial operations
 7 and the day-to-day working.
 8 Q And maybe FINOP covers the trading aspect.
 9 Just curious -- are you involved in the trading of the
 10 CMOs at Tri-Star Financial?
 11 A All three of the owners of Tri-Star Financial
 12 are very engaged in the trading, but we also have three
 13 very, very successful traders. That would be Leslie
 14 Gaylord, Debbie Johnson, and Chamie -- that's with a C --
 15 C-H-A-M-I-E -- Orsack, O-R-S-A-C-K. So we do have three
 16 traders. Leslie has over 30 years' experience, Debbie
 17 Johnson has over 30 years' experience, Chamie probably
 18 has 12 to 15 years' experience.
 19 Q And are all three of these traders that you've
 20 just listed for us -- are they employees of Tri-Star
 21 Financial?
 22 A Yes, they are.
 23 Q Okay. How long has Ms. Gaylord approximately
 24 been with the firm?
 25 A Over 12 years.

1 Q Okay. What did -- what do you remember Ms.
 2 Durham sharing with you about that conference?
 3 A That there was 2063 which had a caveat in there
 4 that we were unaware of that stated that if we didn't own
 5 the broker-dealer it would be a different situation. If
 6 we did own the broker-dealer and we had to pay attention
 7 to what it is and to change our business model.
 8 Q After being made aware of the 2063 issue what
 9 was your continued involvement as far as that issue went?
 10 After you first became aware of it how involved were you
 11 in further discussions of that issue?
 12 A We were very involved by getting counsel and by
 13 getting our consultant which we had -- was Linda Shirkey.
 14 We had her from the beginning. She was also unaware of
 15 2063.
 16 Q Who is Linda Shirkey again?
 17 A She's in the industry of helping put together a
 18 registered investment advisory firm. She's very, very
 19 astute in the role of investment advisory. She's done --
 20 her resume is just awesome. So we from the beginning
 21 used her to put together Tri-Star Advisors and leaned on
 22 her heavily to help us in the regulatory area.
 23 Q Is Ms. Shirkey affiliated with a firm -- a
 24 consulting firm or is she a solo consultant? Do you
 25 know?

1 clarify. There was a little bit of time involved before
 2 we could get everything put together. But she was in the
 3 very beginning of that.
 4 Q So let me just ask you generally, what is your
 5 understanding of what the types of services that Ms.
 6 Shirkey has provided to Tri-Star Advisors?
 7 A To get our -- to put together the
 8 broker-dealer, let us know what types of reporting we
 9 need to do, all the compliance we need to have ready.
 10 She worked hand-in-hand with Kelly to put everything
 11 together with our compliance manual --
 12 MR. WASHINGTON: The word you used was
 13 broker-dealer. You were actually referring to --
 14 THE WITNESS: The investment advisor -- I'm
 15 sorry. Investment advisor.
 16 BY MS. HARRIS:
 17 Q So I'm sorry. You're saying reporting and --
 18 A Compliance manual, getting ready for audits.
 19 Q Now, for those types of things that you just
 20 generally described -- reporting, helping you with the
 21 compliance manual, getting ready for the audit -- those
 22 types of things, are any of those activities -- are those
 23 activities that you personally also participated in?
 24 A I participated in all the meetings with Linda
 25 Shirkey.

1 A She's a solo consultant to my knowledge.
 2 MR. WASHINGTON: Point of clarification or I
 3 can hold for later.
 4 MS. HARRIS: What's your clarification?
 5 MR. WASHINGTON: That Linda Shirkey actually
 6 had -- she's a founder of a compliance consulting firm --
 7 Advisors Resources.
 8 THE WITNESS: It's a small firm. Am I correct?
 9 MR. WASHINGTON: She has five employees.
 10 BY MS. HARRIS:
 11 Q Now, is Ms. Shirkey actually the person -- of
 12 this larger group of five or some employees is she the
 13 one that actually provides the compliance consulting
 14 personally or is there someone else in her office that
 15 handles that?
 16 A That's who we met with and who -- I don't know
 17 if she farms that out to someone else in her office or
 18 not. But we dealt pretty --
 19 Q Directly with her?
 20 A -- exclusively with her.
 21 Q Okay. And has Tri-Star Advisors had this
 22 consultant relationship with Ms. Shirkey and her firm
 23 since its inception?
 24 A Yes. I will say that we started a corporation
 25 first before we got a compliance officer, so I have to

1 Q Did you actually review, say, drafts of the
 2 compliance manual and things of that nature?
 3 A That would be Kelly -- Kelly Durham's job. But
 4 we were given the final draft and were consulted on many
 5 areas of the compliance manual. I cannot tell you that I
 6 was at every meeting with Linda Shirkey, but I was in the
 7 majority of the meetings with Linda Shirkey.
 8 Q So I think my -- sort of going back to my
 9 question a few minutes ago I'd asked generally, once the
 10 2063 issue was raised basically what was Tri-Star
 11 Advisors' response? Like what happened next? And you
 12 mentioned getting counsel and getting consultant. Was
 13 there a separate legal counsel you hired besides Ms.
 14 Shirkey or were those one and the same thing? I want to
 15 make sure I'm not --
 16 A They're one and the same.
 17 Q Besides getting the consultant, Ms. Shirkey,
 18 was there any other action items taken that you recall
 19 that Tri-Star Advisors did in response to the 2063 issue
 20 being raised?
 21 A Yes. We made sure that we would comply with
 22 all the rules and regulations that 2063 had mandated.
 23 Q And did you lead that compliance effort or did
 24 somebody else do that?
 25 A I would say that would be a team effort between

1 Jon Vaughan, Kelly Durham, and Bill Payne.
 2 Q So why don't you tell me your understanding of
 3 the old procedure? And when I say the old process I'm
 4 talking about what was it about the business model that
 5 Tri-Star Advisors had in place prior to the SEC
 6 examination that you understood raised this issue of
 7 2063?
 8 A I'm going to have to ask you to --
 9 Q Okay.
 10 A -- rephrase the question --
 11 Q Okay.
 12 A -- for me please.
 13 Q Say, in 2010 -- let me just give you some
 14 background. I understand now some of the procedures and
 15 processes of how Tri-Star -- I'm sorry -- Tri-Star
 16 Financial trades is different than it was prior to the
 17 SEC examination. Is that also your understanding?
 18 A Yes, it is.
 19 Q Okay. Let's start with your understanding of
 20 the old process. How did things work prior to the SEC
 21 examination?
 22 A Prior to the examination if we bought a bond,
 23 whether it did or not have any commission to it, we could
 24 put it into 604.
 25 Q And what is 604?

1 the purpose of Tri-Star Financial then we could use 604.
 2 Q Okay. I want to back up. I know that
 3 you're -- seems like you're describing what happens now
 4 to allocation. I want to back up and say what used to be
 5 that case -- like when you purchased a fixed income
 6 security with a markup how was that processed the old
 7 way?
 8 A For which entity?
 9 Q For -- when Tri-Star Financial goes out
 10 and buy -- well, let's just start from the beginning.
 11 Why don't you walk me through a typical CMO transaction
 12 for an advisory client? Say, you've met with a client,
 13 you've identified -- you've met with them, you assessed
 14 we think a CMO makes sense for this particular client,
 15 you figured out what the parameters are, let's go get it.
 16 What happens next? And I'm talking baby steps. Walk me
 17 through how it used to walk in the old process.
 18 A All right. Then you would buy the bonds, put
 19 it into 604, put what you thought was a -- the type of
 20 markup that the bond could take. It would always be a
 21 less markup than you would for a client that was a
 22 non-managed account. There was always a lesser amount.
 23 So whatever it was we'd always make sure that the managed
 24 clients were not marked up as high as the non-managed
 25 clients. And then we would put them into their

1 A 604 is our inventory account. So as far as
 2 Tri-Star Financial we could no longer -- whether
 3 commission, markup, markdown, whatever was going to
 4 happen -- we could no longer use 604. We had to go and
 5 use a different account number and use it for the
 6 allocation that would go directly into the investment
 7 advisory client at Tri-Star Advisors.
 8 Q Okay. So is the 604 account not being used
 9 anymore? Is that what I am to understand from what you
 10 just said?
 11 A 604 is only used if there is a markup or
 12 markdown condition that's going to happen before anything
 13 that would be related to a position that our clients
 14 would not have to have the authority -- or give us the
 15 authority to do the trades in. It would have to go
 16 through a separate account.
 17 So if a client wanted a bond that they
 18 understood there was a markup and they would agree to and
 19 sign off for it could go into a account that would be the
 20 allocation account. That is different. So you have to
 21 set up two accounts now that are set up. One would be
 22 604, one is a different account.
 23 So if there was no commission to be made at
 24 all -- markup or markdown -- it would have to be into one
 25 account. If there was any type of markup or markdown for

1 respective accounts as far as the allocation to the type
 2 of clients that were interested in that type of product.
 3 Q Okay. So let me just summarize my
 4 understanding and tell me if I got this right. The old
 5 process -- Leslie Gaylord would go out and find the
 6 appropriate fixed income security using our scenario.
 7 Tri-Star financial would buy that using its 604 inventory
 8 account. So the security would come into the 604
 9 account, markup -- however that would be determined --
 10 would be applied to that, and then that would be resold
 11 to -- directly to the advisory client's account. Is that
 12 correct?
 13 A Correct.
 14 Q Okay. I'm going to hand you an Exhibit 4 --
 15 and before we get to that let me just ask you, was
 16 there -- how's the markup determined under the old
 17 scenario?
 18 A Again, that would be between the traders of how
 19 long it took to get the bond -- there's so many
 20 indicators of what the markup would be. There wasn't
 21 just an exact amount. So it would vary from each bond.
 22 Some bonds can hold the mark, some bonds can't, some are
 23 hard to find -- so every one would be different.
 24 Q Who makes the determination? Is there a
 25 committee that meets to decide what the markup is on each

1 or form then they're brought to my attention.
 2 Q Okay. Let me just back up a little. I guess
 3 what I'm trying to understand is what process does
 4 Tri-Star Financial have in place to ensure that any
 5 markups -- markup limits are not exceeded in the context
 6 of folks reviewing the trade tickets?
 7 A Again, every trade has to go through one of our
 8 traders, and they know the markup limits. Our head
 9 trader, Leslie Gaylord, would draw that to my attention
 10 very quickly.
 11 Q Do you recall that ever happening?
 12 A To my knowledge everybody pretty much knows
 13 what the limits are. I'm not saying a broker doesn't
 14 give it a good shot. But every once in a while I would
 15 get that, but we would quickly remedy the situation.
 16 Q And besides the traders reviewing the trade
 17 tickets is this also your understanding that the
 18 compliance officer also reviews the trade tickets?
 19 A Yes. The compliance officer signs off on all
 20 the trade tickets and reviews to make sure that they're
 21 not over the limits.
 22 Q You walked us through the old process on a
 23 fixed income security process through Tri-Star Financial.
 24 Now I'd like to shift to how does it happen today. I'm
 25 going to hand you a document that's been marked Exhibit

1 security trades.
 2 A So this is a flowchart so that everyone
 3 understands how it is supposed to be done from the
 4 traders to the back office so that we're in compliance
 5 with 206(3).
 6 Q Okay. Walk us through the box, like what's
 7 happening.
 8 A On the right side for your non-managed accounts
 9 where you buy it into inventory, so you buy that bond
 10 into inventory. That's where the desk would make what
 11 you would call the trader's profit into there which is
 12 part of what the inventory account would take. If it was
 13 a non-managed account, that's where it would go. For all
 14 non-managed accounts, from there it would go into account
 15 number 115 inventory, and then sold to the respective
 16 clients.
 17 Q What happens if there's any distinction between
 18 the managed accounts on the left-hand side?
 19 A On the left-hand side, then you have two
 20 categories that would happen into there. Number one is
 21 that if there was going to be a markup added, you would
 22 have to first send letters to your clients, make sure
 23 that they agreed with the markup, complied with the
 24 markup, if they did that. If not, if there was no markup
 25 at all, we would not have to advise our clients and this

1 Number 4. There are in this exhibit -- you're welcome to
 2 look at as much of it as you'd like -- but there's ticket
 3 procedures for fixed income securities is at the back.
 4 My understanding is that this is the new procedure that's
 5 in place today, so I'm going to give you a chance to look
 6 at it and walk me through the flowchart. Okay?
 7 Mr. Payne, have you had a chance to familiarize
 8 yourself with Exhibit 4?
 9 A Yes, I have.
 10 Q Let me just ask you before we get started, you
 11 are a recipient of this email, just based on the emails
 12 on the first page. Do you remember this document?
 13 A I remember it -- yes, I remember this.
 14 Q Okay. And again, just to give you some
 15 context, my understanding is, given the dates of these
 16 emails from Ms. Binkley on August 4, 2011, this was an
 17 attempt at documenting the new procedures that would be
 18 put in place with respect to trades following the SEC's
 19 examination. Do you agree with that, or does that seem
 20 to comport with your understanding as well?
 21 A This is how I agree that it's done.
 22 Q Okay. All right. Well, let's take a look at
 23 Bates Stamp page 3396, and if you would, real slowly just
 24 kind of walk us through what we're looking at here and
 25 describe for us the new procedures for fixed income

1 would be the flow through for our clients.
 2 I don't see the one box here about if there was
 3 or was not a markup to be added, because we have clients
 4 if there is no markup, it goes directly into the one
 5 account that is marked strictly 15-4, no markup, no
 6 markdown. We don't need a letter to our clients. If
 7 there is going to be a markup, then it would go into what
 8 is on the left-hand side.
 9 Q Okay. And it looks like everything, again,
 10 starts with the 64 account. Is that correct?
 11 A Correct. We have to put it into there.
 12 Q And then it goes next to something what looks
 13 like an I15 inventory account.
 14 A Correct. I don't know if that's an I15 or a
 15 115.
 16 Q And what's the purpose of that I15 inventory.
 17 A Again, the inventory account is just to
 18 separate the accounts out now so that it goes to managed
 19 or non-managed accounts. And I believe right now, again,
 20 I'm not the one that does the allocation for the exact
 21 bonds, but if it has no markup or markdown right now, one
 22 of the procedures is we've got where it goes directly --
 23 if there's no markup or markdown it goes directly into
 24 this I15 account, it does not go through 604, we're not
 25 allowed to put anything into 604 as far as that because

1 the next month, so whatever business would be done in
 2 July would have been paid out yesterday.
 3 Q What is Ms. Gaylord's base salary?
 4 A I wish I could remember off the top of my head.
 5 I don't know, but I'm going to say \$2500 per pay period,
 6 \$2500 to \$3500 per pay period. Please don't hold me to
 7 that.
 8 Q And a pay period is twice a month.
 9 A That is correct.
 10 Q Let's take a look, I've got a couple of
 11 documents I'm going to put in front of you, they've both
 12 been previously marked as exhibits, they are Exhibit 6
 13 and Exhibit 7.
 14 Mr. Payne, do you recognize Exhibit 6?
 15 A It's been a long time since I've seen it but
 16 I've seen the format, yes.
 17 Q I'm sorry. You're looking, I think, at
 18 Exhibit 7.
 19 A Oh, I'm sorry.
 20 Q Let's start with 6. Do you recognize
 21 Exhibit 6?
 22 A Yes, I do.
 23 Q Okay. And can you tell me what this is?
 24 A This is a run from Southwest Securities of our
 25 sales records.

1 A It just shows the individual clients on a
 2 particular date and what they have earned from the gross
 3 commission, minus the ticket fee and then the net
 4 commission.
 5 Q And to your knowledge, who prepares Exhibit 7?
 6 A Debbie Binkley.
 7 Q And I guess what is the point of you, Mr.
 8 Payne, reviewing information in Exhibit 7? What are you
 9 looking for?
 10 A I'm looking to make sure that it's concise and
 11 correct and if we've made any mistakes.
 12 Q Well, how do you know if it's concise and
 13 correct? Are you comparing it to something else?
 14 A I am not comparing it to anything else but I
 15 know most of the clients, whose clients they are, if it
 16 looks like something is off. I don't go each individual
 17 one but I take a good review to make sure it looks as
 18 accurate as possible.
 19 Q So what would be out of whack?
 20 A Sometimes the percentages may be out of whack
 21 on to the trade or the amount or these numbers, the gross
 22 commission would be too big on a trade, or just something
 23 that would be out of the normal.
 24 Q Have you had occasion in which you did notice
 25 something abnormal about information in a report like

1 Q Now, the document we're looking at, Exhibit 6,
 2 clearly is for a particular rep and a particular time
 3 period, but just generally, is this the type of report
 4 that you typically review on a normal basis?
 5 A I do not review these at all. Our FINOP,
 6 Debbie Binkley, is the one that processes this kind of
 7 information.
 8 Q So in the normal course of business, you don't
 9 see these. Is that correct?
 10 A That is correct.
 11 Q All right. Let's move over to Exhibit 7 real
 12 quickly. Do you recognize Exhibit 7?
 13 A Yes, I do.
 14 Q And can you tell me what this is?
 15 A This would be the commissions for Jon Vaughan
 16 from February 23 to March 22, 2011, payable on 4/15 of
 17 2011.
 18 Q Now, the report we're looking at in Exhibit 7,
 19 is this the type of report, aside from the fact that it's
 20 very particularized to Mr. Vaughan for a particular time
 21 period, is this the type of report that you typically
 22 review on a regular basis?
 23 A Yes, it is.
 24 Q Why don't you tell us sort of what that review
 25 entails.

1 Exhibit 7?
 2 A Every once in a while Debbie makes a mistake
 3 that I catch.
 4 Q Like what?
 5 A Sometimes the percentages may be off, sometimes
 6 the calculation may be wrong.
 7 Q I'm sorry. What percentages are you referring
 8 to?
 9 A Usually down at the bottom on the percentage to
 10 the rep or the amount. More of it is just clerical
 11 errors that may be made from time to time.
 12 Q Do you recompute the percentage, the split?
 13 A No, I do not.
 14 Q You just eyeball it and see if it kind of looks
 15 right.
 16 A Correct. And I can look at it because I
 17 usually get it in electronic form and you can do it by
 18 Excel and double check.
 19 Q So obviously here in Exhibit 7 we're looking at
 20 trades that Jon Vaughan has made for his clients.
 21 Besides Mr. Vaughan's trades, do you review other
 22 brokers' trades?
 23 A I review all the trades once a month.
 24 Q Okay. And do you make any notation, a
 25 sign-off, do you send an email to someone saying that

1 to distinguish between. You had mentioned that you told
2 the clients there was a lower fee associated with the
3 purchase of the CMOs if they were an advisory client than
4 if they were a broker-dealer client, and I think where
5 were headed was it's not necessarily lower, is it. It
6 may be higher if they hold it for an extended period, it
7 may be lower if they don't. Is that fair?

8 THE WITNESS: That's fair.

9 MS. GUNN: Okay. I think that's really all we
10 were trying to establish.

11 BY MS. HARRIS:

12 Q And in going back to that, we were talking
13 about disclosures and the sentences in this letter talks
14 about discussions that both you and Mr. Vaughan said that
15 you have with clients about the types of fees that they
16 would be charged. And we've already covered some of the
17 oral disclosures, and I think you said you do those at
18 inception of the client relationship. Is that correct?

19 A Correct.

20 Q Okay. Other than that point in time, were
21 there any other subsequent times that you sort of
22 reiterated, you know, hey, client you do realize that if
23 we do this trade, you're going to have to pay this and
24 this? Did you ever make any of those followup
25 disclosures?

1 that if there's a fee charged, and I show them the letter
2 that we would be using if there is a fee involved in the
3 purchase of those securities, and if there's not, that
4 you will not be seeing it.

5 Q Okay. And the fee, you mean the markup.

6 A Markup or markdown.

7 Q All right. Now -- and again, I'm focused on
8 the language that you guys used in this letter to the
9 exam staff, that's why I'm trying to understand exactly
10 what you meant. Again, kind of going back to
11 discussions -- now let's move away from any oral
12 disclosures that you had with clients or potential
13 clients about TSA fees and TSF fees -- in the past what
14 was your understanding of the type of written disclosures
15 that would be given to clients that would lay that out
16 that you will be charged a TSA fee and a TSF fee as well?

17 A In the ADV.

18 Q And when did the client or potential clients
19 get the ADV?

20 A At the inception.

21 Q Again sticking to the past, were there any
22 other written disclosures, to your knowledge, that were
23 provided to clients besides the ADV?

24 A Not to my knowledge.

25 Q Now moving to what happens today currently,

1 A Now or in the past?

2 Q In the past. Prior to the SEC exam.

3 A Prior to the SEC, no, not to my recollection.

4 MR. WASHINGTON: But with respect to the
5 principal transactions that attributed to TSA, the answer
6 is no, but there were things done with respect to TSF
7 from the confirmations and the designation and the
8 confirmation that the transaction was a principal
9 transaction, those things that are specified within the
10 confirmations.

11 MS. HARRIS: Yes, and I'm not talking about
12 confirmations, I'm talking about oral disclosures that he
13 had.

14 MR. WASHINGTON: Okay. Because there are some
15 written ones within the ADV.

16 MS. HARRIS: Right. We're just talking about
17 the oral disclosures, so I'm trying to parse this out and
18 not get into that. We'll get in the written stuff in a
19 second.

20 BY MS. HARRIS:

21 Q And so that was in the past when you said that
22 basically your disclosures were made at the inception of
23 the relationship. How is that changed today? Has it
24 changed today?

25 A Yes. Today I basically would let them know

1 what are the written disclosures that you're aware of
2 that are provided to clients to explain the types of fees
3 that they will be paying?

4 A Number one is the letter that they have to sign
5 and send back on each transaction when there is a markup
6 or a markdown, and the ADV.

7 Q And when you say markup or markdown, are you
8 including both of the two markups that we saw in
9 Exhibit 4, the trade desk markup and the rep markup?

10 A Yes, we are.

11 Q Have you personally had to employ the new
12 disclosure and consent process that's currently in place,
13 as I understand it?

14 A Yes.

15 Q Okay. Tell us how that works.

16 A Most of the time we use fax, we'll fax it to a
17 client, explain what we're doing, how it's working, and
18 they send it back with the okay, and/or if they don't
19 have a fax machine which is pretty rare, then they have
20 to sign it and send it back.

21 Q And how are those procedures working, in your
22 estimation?

23 A Very clumsy.

24 Q And what do you mean by clumsy?

25 A Well, sometimes a client is on vacation for two

PROOFREADER'S CERTIFICATE

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In The Matter of: PARALLAX INVESTMENTS, LLC
Witness: William Thomas Payne
File Number: FW-03686-A
Date: Thursday, August 16, 2012
Location: Houston, TX

This is to certify that I, Donna S. Raya,
(the undersigned), do hereby swear and affirm that the
attached proceedings before the U.S. Securities and
Exchange Commission were held according to the record and
that this is the original, complete, true and accurate
transcript that has been compared to the reporting or
recording accomplished at the hearing.

Donna S. Raya

(Proofreader's Name)

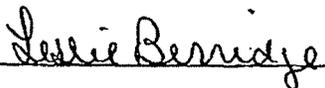
8/22/12

(Date)

CERTIFICATE OF REPORTER

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I, Leslie Berridge, hereby certify that the foregoing transcript consisting of 137 pages is a complete, true, and accurate transcript of the investigative hearing indicated, held on August 16, 2012, at Houston, Texas, in Parallax Investments, LLC. I further certify that this proceeding was recorded by me, and that the foregoing transcript has been prepared by me or under my direction.



Official Reporter